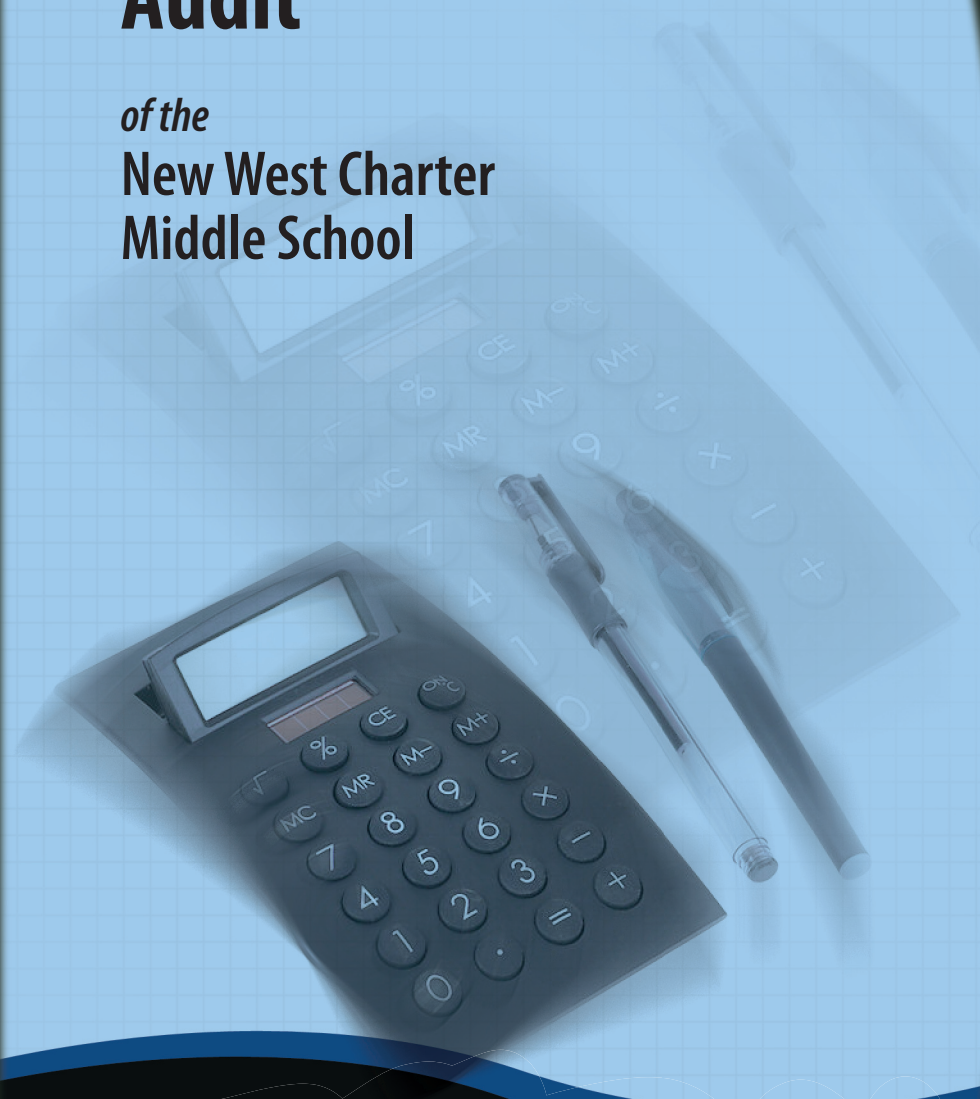


Extraordinary Audit

of the
**New West Charter
Middle School**



**Commissioned by the Superintendent
of Public Instruction in Cooperation
with the Superintendent of the Los
Angeles County Office of Education**

December 5, 2005

**Administrative Agent
Larry E. Reider
Office of Kern County
Superintendent of Schools**

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EXECUTIVE SUMMARY

As a result of a March 2005 audit memorandum from the Audits and Investigations Division (A&I) of the California Department of Education (Department), the State Superintendent of Public Instruction, the State Board of Education, and the Los Angeles County Superintendent of Schools requested that the Fiscal Crisis and Management Assistance Team (FCMAT) conduct a follow-up audit of New West Charter Middle School's (New West) progress in implementing A&I's recommendations¹ and to follow-up on unresolved issues from the A&I review. MGT of America, Inc. (audit team) contracted with FCMAT to conduct the audit. Overall, the audit team found that New West has implemented numerous new policies and procedures to improve its internal controls; however, they have not been consistently implemented. The school appears to be fiscally viable with an improving fiscal outlook, but is not well prepared for any financial setbacks because of its limited cash reserves. Additionally, the audit team was able to resolve many of the unresolved issues from the A&I audit; however, some issues remain unsettled. Even though the audit team did not find evidence of improprieties, unresolved issues related to missing equipment and unsubstantiated expenditures remain. Until New West consistently implements adequate administrative internal controls, it cannot ensure it is adequately protecting its assets or giving itself the best opportunity to succeed.

New West, located in Los Angeles, California, began operations in September 2003. As of November 2005, New West has a student average daily attendance of approximately 285 students in grades 6 through 8. The goal of New West is to produce competent, independent, self-reliant students by creating a learning environment that promotes academic excellence and strong character. New West is open to all students who seek a rigorous core curriculum that provides a strong foundation in reading, language arts, mathematics, science, history, and social science.

New West Developed New Fiscal and Administrative Procedures But Has Not Consistently Implemented Them

Although New West has shown signs of improvement since the A&I audit, the audit team found that it does not consistently exercise proper internal controls. Specifically, the school fails to consistently obtain approval prior to making all purchases, document invoices and receipts, and prepare receipt of goods documentation. Further, New West does not consistently obtain two signatures on checks of \$1,000 or more as recommended by A&I and required by the school's own policies. Although improvement is evident, New West also does not consistently adhere to its policy for depositing checks in a timely manner. The audit team did find that New West implemented adequate control procedures for its fixed assets. Specifically, New West updates its fixed-asset spreadsheets and general ledger in a timely manner, includes detailed information about the assets, and tags each asset with a unique identification number. As a result of implementing these new procedures, New West found 10 fixed-asset items that were missing. They were unable to account for three of these items.

In reviewing New West's fiscal viability, the audit team found that New West's historical and projected cash flows appear to provide only a limited reserve for contingencies. Additionally, New West does not have written policies for cash-flow management and budgeting, cash-flow contingency plans, or adopted cash reserve goals, which would help mitigate cash flow issues. Although New West's operating activities appear to be providing an adequate cash flow to support needed renovations to the school, the costs of renovations leave the school with minimal contingency funds. Moreover, the school's net asset reserve fell below the state's recommended reserve level in fiscal year (FY) 2004-05, but shows signs of improving in FY 2005-06. Given that the student enrollment increases are consistent with projections thus far in FY 2005-06 and that New West is making concerted efforts to contain and reduce expenses, it is reasonable to project that the school will realize a larger reserve in FY 2005-06 than in FY 2004-05. Indications are that the FY 2005-06 reserve will exceed the recommended five percent threshold. Finally, although New West appears fiscally viable at this time, it needs to closely monitor its cash flows, improve its cash management practices, and monitor contract and expenditure authorizations.

New West recently developed new contracting procedures; however, the school could improve these procedures by adding processes to require monitoring of contracts, documenting competitive bids obtained, and documenting the need for the product or service obtained. Moreover, New West did not follow its procedures or sound internal controls in two of the eight contracts reviewed. Well-designed contracts and contracting procedures help minimize the risk of experiencing misunderstandings and disputes over contract terms, which can sometimes result in costly losses or litigation.

New West improved its governing procedures and processes following the A&I audit. Specifically, the process used to tally the vote for a November 2005 governing board election was in accordance with New West's election procedures and adequate to ensure a fair and impartial election. Moreover, New West readopted its conflict-of-interest code and obtained conflict-of-interest disclosures from all relevant personnel.

Many Prior Audit Questions Related to FY 2003-04 Resolved—Some Questions Remain

As part of the audit, the audit team followed up on unresolved issues from the A&I review, verified prior review observations, and assessed prior observations. The team then identified areas of concern or misconduct, quantified any irregularities, and made recommendations for improvement.

The audit team reviewed some questionable purchases identified by the A&I auditors. Specifically, A&I identified some FY 2003-04 purchases that were:

- ▶ Sent to locations other than the school.
- ▶ Billed to entities/individuals other than the school.

- ▶ Supported by invoices that were questionable in appearance.
- ▶ Paid for using personal credit cards with no other supporting documentation.
- ▶ Not consistently supported with invoices or receipts.

For example, the audit team reviewed a \$45,981 computer purchase made by a New West founder (who was also the council president at the time) on his personal credit card. The audit team accounted for 44 of the 48 computers purchased. Of the missing four, a homeless person stole one, and another was never returned by a teacher who left the school. The school cannot account for the other two computers from this purchase because it did not maintain inventory records. Moreover, the audit team followed up on the invoices that were incomplete or questionable in appearance by researching the vendors on the Internet and/or with the Secretary of State's Office. The audit team also verified, where applicable, the existence of purchased assets by vouching the assets to the fixed-assets or textbooks register and physically viewing some of the assets, reviewing receipts and invoices, and verifying the purchases with the vendor. However, as discussed further on the next page, New West could not support some FY 2003-04 payments totaling more than \$9,000 with receipts or invoices and was unable to identify the nature of some purchases. Nevertheless, the audit team found that all the vendors existed. Although the audit team did not find evidence of improprieties, it is clear that New West's procedures and controls over fixed assets and expenditures were inadequate at the time of the A&I audit.

The audit team reviewed the propriety of four questionable loans obtained by New West during FY 2003-04. Although the loan administration was sometimes poor, the audit team found no evidence of impropriety. Specifically, The Eagles Peak Charter School (EPCS) provided New West with a cash flow loan of \$50,000 in July 2004. Although the audit team found no evidence of improper relationships and found that both entities properly authorized and approved the loan, New West did not obtain formal approval from EPCS for two repayment extensions before missing the repayment deadlines. Moreover, in February 2004, New West's business services manager, Delta Managed Solutions (Delta), wired \$2,000 to the school's account to cover an unexpected cash shortfall. The entities did not execute a loan agreement, and New West did not gain approval for the transaction from its governing council. Although this transaction raised concerns, the audit team found no evidence of improper relationships, and New West repaid the loan in full within three weeks. Further, in July 2003, New West signed a promissory note for an interest-free, short-term loan from a school parent. However, the parent issued a \$100,000 check to New West drawn in her company's name. When New West repaid the loan, it issued a check payable to the parent as specified in the promissory note, not the company, causing A&I to question the propriety of this transaction. The audit team found no evidence of an improper relationship, and found that the parent deposited New West's repayment of the loan into her company's account. Finally, in April 2002, New West obtained a line of credit (loan) from one of its founders to help pay for its start-up costs. The New West governance council could not approve the loan because it had not yet been formed. Further questions arose when the school made loan payments directly to the founder's lending institutions. Although the school did not exercise

sound controls in this transaction, the audit team did not find any evidence of improprieties. New West has since refinanced this loan with a traditional lending institution.

The audit team reviewed the propriety of 20 checks from FY 2003-04 totaling \$10,742.52 (identified in the A&I review), which New West staff members either wrote to “cash” or paid to themselves. New West was able to provide support for \$9,296.44 (87 percent) of the questionable checks, but could not provide support for \$1,446.08 (13 percent). Because of the lack of evidence for some items, the audit team could not determine whether any improprieties occurred.

As discussed in *Chapter 2*, New West has since implemented a Fiscal Procedures Manual that establishes procedures and safeguards for issuing checks. Although the manual does not specifically prohibit writing checks to “cash” or “bearer,” the audit team did not find any such checks during its review of the school’s general ledgers for FY 2004-05 and FY 2005-06.

The audit team was asked to follow up on missing receipts for 16 invoices totaling \$32,841.89 identified during A&I’s audit of New West’s FY 2003-04 transactions. In all, New West provided the audit team with full support for 10 of the 16 items, and partial support for two. In conclusion, the audit team was able to verify the validity of \$23,547.16 of the expenditures identified by A&I, but could not evaluate the remaining \$9,294.73 (28 percent) for reasonableness or propriety due to the lack of receipts or invoices. It is clear that New West neither had nor followed good accounting controls at the time of these transactions.

The audit team was also asked to review debit card transactions, follow up on charges that were questionable in appearance, and review (for adequacy) the safeguarding of New West debit and credit cards. The audit team found no significant irregularities in the debit card purchases, and the school now has only one debit card issued in the name of both the school and the principal. This card is locked in a file cabinet when not in use. An employee also reimbursed the school for an improper debit card transaction identified in the A&I review.

The audit team was asked to determine whether New West developed and implemented procedures to distinguish invoices as “paid” upon the issuance of checks. The audit team found that only 50 percent of the FY 2004-05 invoices and all of the FY 2005-06 invoices tested were marked as “paid.” New West should continue its efforts to implement the practice of distinguishing invoices as “paid” to minimize the risk of making unnecessary duplicate payments.

In following up on some questionable construction contracts and related-party transactions, the audit team did not find evidence of improper relationships, violations of laws, or improper personal benefits.

KEY RECOMMENDATIONS

The following highlights some of the key recommendations from this report. Please refer to the end of each chapter for a complete list of recommendations.

To improve its administrative and accounting internal controls, New West should:

- Consistently implement and monitor its procedures requiring the use of purchase orders and requisitions for purchases, original invoices prior to making payments, and goods received reports with dual signatures.
- Promptly investigate and resolve all items not in compliance with its fiscal procedures.
- Closely control and monitor the use of its debit card.
- Implement a policy for receiving goods during school closures to ensure delivery of all school purchases to the school.
- Revise its policy requiring dual signatures on checks greater than \$1,000 to require dual signatures on all checks.
- Maintain a log of cash and checks received and deposit all cash and checks within seven days of receipt.

To improve its cash position and cash management abilities, New West should:

- Strive to accumulate cash reserves of at least one full payroll and continue its efforts to secure a revolving line of credit for contingencies.
- Establish and implement policies for cash-flow management and cash budgeting, including a cash-flow contingency plan.

To improve its contracting practices, New West should update its contracting procedures to require:

- Contract monitoring to ensure all parties fulfill the terms of contracts.
- Staff to maintain documentation in the contract file evidencing the competitive bids obtained and the justification of need.
- Staff to make all contract modifications in writing and prohibit initiation of services or continuance of a contract until the contract is properly executed, including prior governing council authorization.

The audit team provides the following recommendations to address the deficiencies identified in the A&I audit and in the follow-up of the A&I audit work for FY 2003-04.

To further improve its administration and accounting internal controls, New West should:

- Implement and adhere to all the recommendations in the A&I audit memorandum.
- Prohibit payments for items shipped to an address other than New West, billed to an entity or individual other than New West, or to personal credit cards without approval and proper receipts.
- Create a proper paper trail for all loans including a loan agreement, evidence of governing council approval, and documentation showing approved loan repayment methods.
- Prohibit the writing of checks to “cash” or “bearer.”
- Require staff to distinguish all paid invoices as “paid.”

Finally, New West should continue to seek evidence/justification or seek reimbursement for the unsupported expenditures identified in this report.

CHAPTER I: BACKGROUND

Charter Schools in California

California Education Code Section 47601, also known as the *Charter Schools Act of 1992* (Act), was enacted “. . . to provide opportunities for teachers, parents, pupils, and community members to establish and maintain schools that operate independently from the existing school district structure.” According to this Act, the legislative intent of this law was to:

- ▶ Improve pupil learning.
- ▶ Increase learning opportunities for all pupils, especially those identified as low academic achievers.
- ▶ Encourage the use of different and innovative teaching methods.
- ▶ Create new professional opportunities for teachers.
- ▶ Provide parents and pupils with expanded choices in the types of educational opportunities that are available.
- ▶ Hold the schools accountable for meeting measurable pupil outcomes, and change from rule-based to performance-based accountability systems.
- ▶ Provide vigorous competition within the public school system to stimulate continual improvements in all public schools.

Charter schools are a part of the public school system and may provide instruction in grades kindergarten through 12. Charter schools differ from traditional public schools in that they are exempt from many state laws relating to specific education programs. Because of these exemptions, charter schools have greater fiscal and programmatic flexibility than traditional public schools. A charter school is usually created or organized by a group of teachers, parents, and community leaders or a community-based organization; and is usually authorized by an existing local public school board or county board of education. An agreement (or “charter”) between the authorizing board and charter organizers detail the specific goals and operating procedures for the charter school. Under California law the local school district governing board serves as the primary chartering authority in most cases. County school boards and the State Board of Education (State Board) may also authorize charters under certain circumstances.

Overview of New West Charter School

In May 2000, a group of West Los Angeles parents and community members commenced efforts to create a new charter middle school. New West Charter Middle School (New West) incorporated as a public nonprofit educational entity in November 2000. After denial of its charter by the Los Angeles Unified School District, New West received a charter from the State Board on December 5, 2001. The State Board granted the original charter for the period of July 1, 2002 to June 30, 2005, but after delays in opening the school, extended the period to June 30, 2006.

New West began operations on September 8, 2003, enrolling approximately 275 students in grades six through eight. New West is located in West Los Angeles in a two-storied structure that formerly served as a furniture auction warehouse. The school site has approximately 10,000 square feet of space on the lower level and approximately 5,000 square feet of space on the upper level. In 2003, New West contracted to have the building renovated to accommodate 11 classrooms, administrative offices, library space, an art area, student and adult restrooms, conference rooms, and faculty and parent work areas. The initial renovation also included installation of wheelchair ramps and a lift, making the building fully compliant with the Americans with Disabilities Act. New West further renovated to add a 12th classroom in 2004 and updated its library, added a 13th classroom, and a media center in 2005.

The goal of New West is to provide an academically rigorous, highly individualized education for 21st Century students. New West strives to produce competent, independent, self-reliant students by creating a learning environment that promotes academic excellence and strong character. New West is open to all students in grades six through eight who seek a rigorous core curriculum that provides a strong foundation in reading, language arts, mathematics, science, history, and social science.

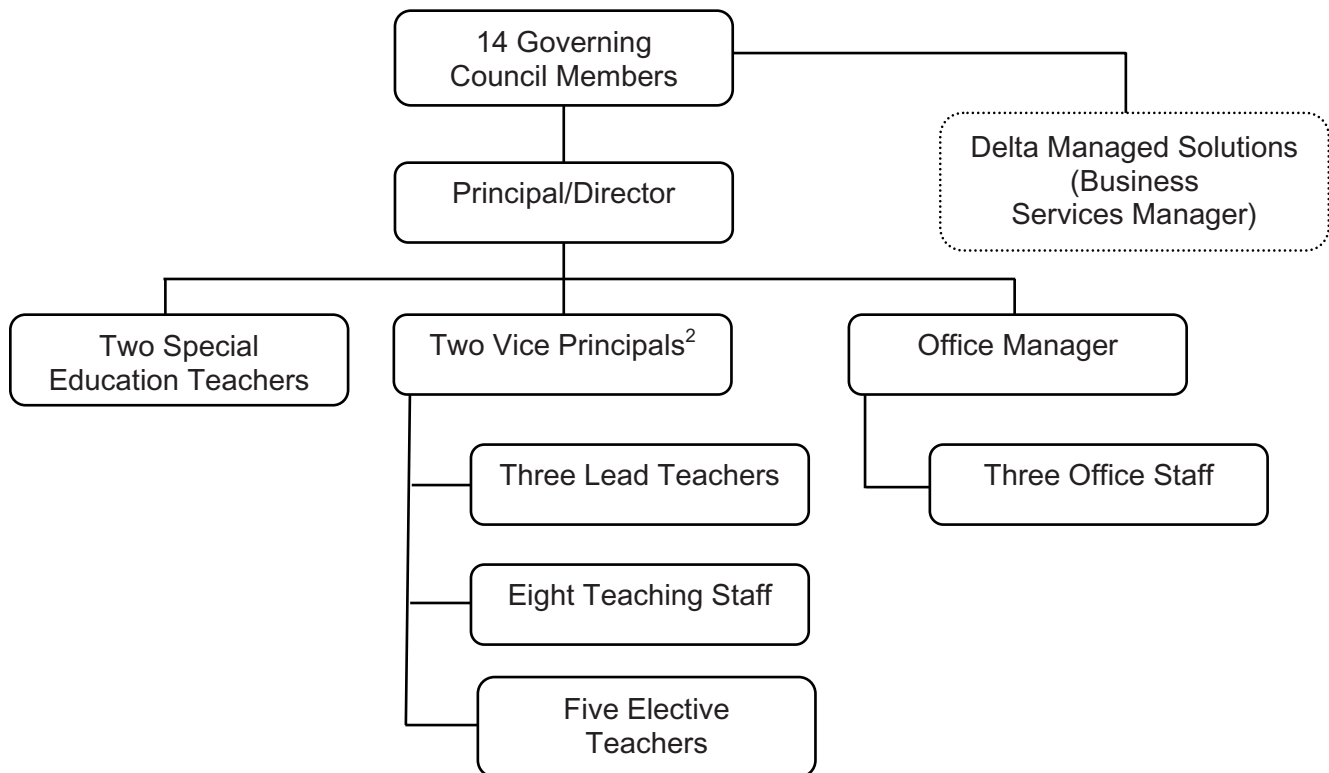
New West Staffing and Organization

The number and types of staff employed at New West varies depending on the level of funding and the number of students enrolled. The chart depicted in Exhibit 1a (please see the following page) shows the current organizational structure of New West.

In 2003, New West's principal/director (principal) worked with founding parents to hire teachers and other staff to prepare for the opening of the school. During 2004, the school experienced some instability in its leadership. The original principal resigned in May 2004. A second principal was hired after a two-month vacancy, but resigned after 3 1/2 months due to health reasons. The school contracted with an interim principal until it could hire a permanent principal in January 2005. As of this November report date, the permanent principal continues in this role.

The school's support staff includes the office manager and three office assistants. The office manager is responsible for a variety of functions including providing support to the principal, handling the admissions process, cash collections, and purchasing. The office staff members assist the office manager and are responsible for maintaining the school's attendance system. New West's teaching staff consists of two special education teachers, three lead teachers, and nine regular education teachers.²

Exhibit 1a
New West's Organizational Structure and Filled Positions
As of November 13, 2005



Source: Delta Managed Solutions.

New West outsources its student attendance accounting, human resources, purchasing system, and fiscal services functions to a company called Delta Managed Solutions (Delta), a Sacramento-based firm. The school initially contracted with Delta in July 2003. According to the contract with Delta, its responsibilities include, among other functions, maintaining the school's general ledger system, processing payroll, reconciling general ledger and bank accounts, and maintaining the school's purchasing system. New West's principal informed the audit team that the school plans to bring the financial functions in-house by hiring a full-time chief financial officer. As a result, the current contract with Delta is on a month-to-month basis.

Limited Scope Review

Because of specific complaints and questionable transactions that came to the attention of the California Department of Education (Department) and the State Board, the Charter Schools Division of the Department requested a special investigative audit of New West. Specifically, the Department's Audits and Investigations (A&I) Division began a limited

scope review of New West in December 2004. The audit period selected for review was July 2003 through June 2004. The A&I audit memorandum, issued in March 2005, contained findings and observations related to the following four primary areas: Internal Controls, Expenditures, Related-Party Transactions, and Other. Appendix A contains a complete summary of the A&I audit findings for fiscal year 2003-04.

In response to the A&I audit findings, the State Board issued a “Notice to Cure” to New West. In its notice to New West, the State Board requested that New West address the issues reported in the A&I audit as well as some findings from New West’s 2003-04 external financial audit.³ The State Board wrote that these audits “. . . contain findings and conclusions that are of substantial concern to the State Board and must be addressed immediately.” The State Board’s notice further stated that the directive constituted “. . . a formal Notice to Cure or Face Revocation under Education Code Section 47607(c).” This section of California’s Education Code states that the granting authority may revoke a charter if it finds the charter has done any of the following:

- ▶ Committed a material violation of any of the conditions, standards, or procedures set forth in its charter.
- ▶ Failed to meet or pursue any of the pupil outcomes identified in its charter.
- ▶ Failed to meet generally accepted accounting principles, or engaged in fiscal mismanagement.
- ▶ Violated any provision of law.

The State Board’s Notice to Cure contained 13 items requesting documentation from New West as detailed in Appendix B. New West provided a response to the State Board by the July 1, 2005 deadline.

Scope and Methodology

As a result of concerns from the State Superintendent of Public Instruction (State Superintendent), the State Board, and the Los Angeles County Superintendent of Schools (County Superintendent), the State Superintendent and County Superintendent made a joint request for the Fiscal Crisis and Management Assistance Team (FCMAT) to conduct a follow-up audit of New West’s progress in implementing the A&I’s nine recommendations and to assess the fiscal and administrative condition of the charter school. In July 2005, FCMAT contracted with MGT of America, Inc., as the audit team to conduct this follow-up audit.

The audit team pursued a number of approaches to obtain the information necessary to accomplish the objectives of this audit. To develop an in-depth understanding of the issues and potential outcomes pertaining to each of the work plan tasks, the audit team interviewed New West employees, council members, and Delta employees.

The audit team developed specific audit procedures to address each of the observations outlined in the A&I audit. For each task, the audit team evaluated whether New West had implemented corrective actions including the implementation of policies and procedures. The audit team performed various tests and analyses to identify areas of continued weaknesses and to assess the degree to which New West improved its internal controls. As part of this audit, the audit team conducted an extensive document review of New West's contract and vendor files, financial statements, accounting records, and governing council records.

As part of the audit, the audit team also reviewed the work-paper documents prepared by the A&I auditors. The audit team reviewed relevant laws and regulations and interviewed A&I staff and Charter School Division staff. In addition, the audit team interviewed Delta staff to obtain an understanding of the accounting processes, procedures put in place, and to obtain background information about why some of the irregularities occurred and what actions New West took to prevent those irregularities in the future.

The audit team conducted the audit in accordance with generally accepted government auditing standards promulgated by the Comptroller General of the United States. These standards pertain to the auditor's professional qualifications, the quality of the audit effort, and the characteristics of professional and meaningful audit reports. Specifically, the audit followed the general standards pertaining to qualifications, independence, and due professional care. The audit team also followed the standards pertaining to conducting the audit fieldwork and preparing the audit report. By following these standards, the audit team ensured the independence and objectivity of the audit team, the analysis, and the resulting findings and recommendations offered in this report.

Audit Team

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CHAPTER 2: SAFEGUARDING OF ASSETS

Controls over Disbursements

Sound internal controls over purchasing and payment processes generally necessitate the following:

- ▶ Evidence of prior purchase authorization in the form of either a purchase order or a signed contract or lease.
- ▶ Separation of duties. The same individual should not perform the following functions: approve purchase requisitions, receive merchandise, approve invoices for payment, record transactions in the books, or review and reconcile monthly account statements.
- ▶ Evidence of inspection validating that items received were in good condition and in the correct quantities.
- ▶ An original invoice.

By requiring purchase approval prior to expending funds, organizations are better able to control their finances, ensure they do not exceed budgets, and prevent unauthorized purchases. It is also critical that organizations only make payment from original invoices. The risk of incurring errors or irregularities increases when organizations make disbursements without an invoice or from a photocopy of an invoice. Segregation of duties is an internal control designed to prevent or decrease the occurrence of inadvertent errors or intentional fraud. Accomplishing this requires that no single individual has control over all phases of a transaction. Finally, verification of item receipt without damage and in the correct quantities helps to ensure the validity of payments.

Summary of A&I Audit Findings for Fiscal Year 2003-04 (Observations 1, 4, and 8)

New West Disbursement Functions Had Significant Control Weaknesses

The A&I auditors conducted a limited scope review of New West's internal controls to assess the adequacy of its fiscal management and compliance with its charter. This review identified several weaknesses in the school's disbursement functions that fall into one of the following categories:

Lack of Separation of Duties. The A&I auditors found that New West's office manager had the ability to purchase goods and services, receive goods and services, generate checks, and sign checks. The auditors also found that the council's chair had similar access to the school's funds and made several unrestricted purchases that New West subsequently reimbursed without question.

Failure to Follow Fiscal Guidelines. A&I auditors reported that New West’s council approved guidelines for its bank accounts in July 2004 specifying that “. . . any check above \$2,500 requires a signature from two of the following people – the council chair, the council vice chair, the chief financial officer, the finance manager, and the executive director.” In spite of this check-signing requirement, the auditors found that New West staff did not consistently follow the dual signature procedure.

Lack of Supporting Documentation and Audit Trail. The A&I auditors found that “Documentation maintained by New West as support for their expenditures does not provide an adequate audit trail to ensure that . . . costs are related and necessary to the school.” Examples of inadequate documentation cited in the audit include:

- ▶ Expenditures paid based on credit card statements without original invoices.
- ▶ Payment of invoices billed to entities other than New West.
- ▶ Payments made without an original invoice.

Duplicate Payments made and Items Shipped to Addresses other than the School’s Address. The A&I auditors noted that because New West made payments without original receipts, they found instances of duplicate payments. In addition, some invoices tested had addresses other than the school’s address.

The A&I auditors reported that these weaknesses resulted in the school making duplicate payments and being unable to justify the reasonableness and necessity of its expenditures.

Status of New West’s Corrective Action as Determined by the Audit Team

New West Has Developed Policies for Procurement and Disbursement, but is Not Consistently Following Them

New West continues to be deficient in maintaining adequate internal controls over its expenditures. Specifically, it still fails to gain proper approval prior to making all purchases, document invoices, and prepare receipt of goods documentation. Without proper controls and documentation, New West cannot ensure its purchases are valid or necessary and exposes itself to a greater potential for fraud or misappropriation.

New West’s Fiscal Procedures Manual, revised and updated as a result of the A&I audit, now requires documented evidence to ensure prior authorization for purchases that do not require a contract. New West’s Fiscal Procedures Manual states, in part, “A Purchase Requisition Form or other documented evidence of principal approval must be obtained *prior* to purchase— reimbursements will not be acceptable unless specifically exempted by the principal or board from this reimbursement policy.” The manual further restricts purchasing authority by setting spending limits on amounts that the executive director

can authorize without council approval. Specifically, the manual states: “The primary person responsible for approving all purchases is the principal. For certain purchases exceeding \$5,000, board approval is also required . . .” The manual also requires that when the school receives goods: “at least two staff members must be present to ensure that the items received match the packing slip—both members should sign the packing slip if all delivered items are accounted for.”

To test New West’s adherence to its purchasing and payment procedures, the audit team reviewed a sample of 49 invoices dated between July 2004 and June 2005 and an additional 16 invoices dated between July 2005 and September 2005. Please see Exhibit 2a for a summary of testing results. As the exhibit shows, 92 percent of the FY 2004-05 documents and 44 percent of the FY 2005-06 documents contained exceptions. Specifically, expenditures lacking prior approval ranged from 67 percent in FY 2004-05 to 13 percent for the three-month period in FY 2005-06. Twenty-five percent of expenditures in FY 2004-05 and six percent of expenditures in FY 2005-06 lacked adequate documentation. New West showed little improvement in following its procedure that requires staff to document the receipt of goods. Specifically, 12 of the 17 transactions for goods (71 percent) in FY 2004-05 and four of the six FY 2005-06 transactions for goods (67 percent) did not have adequate receiving documentation. The two FY 2005-06 items tested that had a receiving report contained dual signatures as required. Although New West shows improvement in each area since it implemented its new procedures in April 2005, the results indicate that staff are not consistently following New West’s procedures.

Exhibit 2a
Summary of Findings from Testing of New West’s Procurement/Disbursement Practices

Exception	2004-05 Sample Period ^a		2005-06 Sample Period ^b	
	Number of Expenditures	Percent	Number of Expenditures	Percent
Contained one or more exceptions	45	92	7	44
No authorization prior to purchase	33	67	2	13
No supporting invoice	12	25	1	6
Receipt of goods not documented	12 ^c	71 ^c	4 ^d	67 ^d
Payment not made within 30 days of invoice date	6	12	0	0

Notes: (a) Sample size = 49 documents.

(b) Sample size = 16 documents.

(c) Only 17 of the 49 documents were for the receipt of goods.

(d) Only 6 of the 16 documents were for the receipt of goods.

Moreover, the audit team scanned the school's general ledger detail for unusual activity and identified several items with notations such as "missing receipts" or "missing requisition." Exhibit 2b summarizes the results of this general ledger review.

Exhibit 2b
Payment Irregularities Noted in New West's General Ledger
As of June 30, 2005

Date	Expense	Account	Payment Type	General Ledger Notation
2/14/2005	\$51.96	Other supplies/office	Debit card	Needs to be categorized
4/8/2005	1,484.47	Instructional materials	Debit card	Missing requisition/receipt
4/12/2005	99.32	Temporary adjustment account	Check	Requisition/receipt missing
4/12/2005	7.90	Temporary adjustment account	Check	Requisition/receipt missing
4/12/2005	197.10	Temporary adjustment account	Check	Requisition/receipt missing
4/13/2005	25.00	Temporary adjustment account	Check	Requisition/receipt missing
4/13/2005	25.00	Temporary adjustment account	Check	Requisition/receipt missing
4/18/2005	42.02	Other supplies/office	Debit card	Missing requisition/receipt
4/18/2005	62.44	Other supplies/office	Debit card	Missing requisition/receipt
4/21/2005	162.31	Other supplies/office	Debit card	Missing requisition/receipt
4/28/2005	25.00	Temporary adjustment account	Check	Requisition/receipt missing
5/11/2005	10.00	Temporary adjustment account	Check	Requisition/receipt missing
5/12/2005	16.51	Travel and conferences	Debit card	Missing requisition/receipt
5/17/2005	458.82	Other supplies/office	Debit card	Missing actual receipts—cannot determine exact amounts
6/1/2005	478.12	Other supplies/office	Check – reimbursement	Missing requisition/receipt
6/6/2005	264.70	Lunch program	Check	Missing receipt
6/30/2005	460.00	Silent auction	Check	Missing requisition
6/30/2005	128.56	Other supplies/office	Debit card	Missing requisition/receipt
Total	\$3,999.23			

It is important to note that of the 18 transactions listed in Exhibit 2b, eight transactions were made with debit cards,⁴ indicating a weakness in New West's internal controls related to the use of the debit card. This issue is discussed further in the next section. Delta's financial officer explained to the audit team that when transactions occur (at the school site) for which documentation is lacking, Delta records the transaction in the books, and then it requests documentation from the school. After the audit team pointed these items out to New West, the school was able to provide receipts and invoices for all but four of these items. However, the fact that four items still lack adequate documentation and that New West did not follow up on most of these items for more than six months raises concerns about the monitoring and controls in place over expenditures. In addition, failure to have an approved requisition or making a payment without an original invoice is against New West policy and generally accepted accounting practices, and could lead to unauthorized transactions or misappropriation of funds.

Because the A&I audit uncovered duplicate payments and questioned the validity of items shipped to locations other than the school, the audit team tested a sample of FY 2004-05 and FY 2005-06 transactions to determine whether New West had addressed these concerns. Although the audit team did not find any instances of duplicate payments made by New West in the sample, the audit team did find one purchase made from an online bookseller for \$463.57 that contained a "ship to" address that did not match the school's address. Delta's financial officer explained that New West made this purchase just before the winter break school closure. The teacher responsible for ordering the books had the books delivered to her home address so the books would be ready for use when the school reopened. Although the audit team was able to verify the invoice and the existence of the books, having items shipped to locations other than the school increases the possibility for embezzlement or invalid transactions.

The audit team also reviewed the transactions in the sample to ensure that all invoices named New West as the invoicee. The test found no instances in which New West made payments for items billed to other entities.

Moreover, the audit team found several transactions recorded to an account called "As-Yet Uncategorized." Delta's financial officer explained that Delta uses this account to temporarily record items (purchased at the school site) lacking sufficient detail and that these items are later reviewed and reclassified to the correct account. Exhibit 2c (please see following page) shows the detail of this activity.

Exhibit 2c
Detail of New West's Uncategorized Accounting Activity
As of June 30, 2004

Date	Amount	
	Revenues	Expenditures
12/16/04	\$1,397.13 ^a	
12/20/04	559.24 ^a	
1/3/05	2,604.59 ^a	
1/4/05	12.00 ^a	
1/13/05		330.91
1/21/05		100.00
6/7/05		28.50
6/15/05		45.00
Totals	\$4,572.96	\$504.41

^a According to Delta's financial officer, New West could not identify which fundraising activity to attribute the revenue to.

Together, these uncategorized entries represent \$5,077 (\$4,573 in revenues and \$504 in expenditures) in school transactions that New West had not properly accounted for as of July 26, 2005, the date of the detailed general ledger the audit team reviewed. Delta recorded more than one-half of these unresolved transactions more than five months earlier. Delta has stated that it properly reclassified these items in New West's general ledger when it closed the books in September 2005. However, failure to properly investigate and trace unidentified activity in a timely manner not only results in erroneous financial records, but also makes correction more difficult as time passes.

New West Does Not Consistently Follow Its Procedure Requiring Dual Signatures on Checks for More Than \$1,000

Although New West's procedures now require two signatures on any check of \$1,000 or more, the audit team found that New West does not consistently follow this procedure. This is an important control designed to reduce the possibility of embezzlement or misappropriation of large amounts of funds.

New West's April 2005 fiscal procedures state: "For payments exceeding \$1,000, a second signature is required. The second signatory should be the office manager or a designated alternate when the office manager is not available." To test whether New West follows this procedure, the audit team examined all checks of more than \$1,000 that cleared the school's bank account for the months of May through August 2005. Although the effective date of the procedure was in April 2005, none of the 26 May checks the audit team

reviewed contained a dual signature. Of the 21 checks greater than \$1,000 and clearing New West's bank account in June, 15 (71 percent) contained dual signatures. All 13 of the July checks, but 19 of 23 August checks (83 percent) that were greater than \$1,000 contained the required dual signatures. The principal told the audit team that even though all checks go to the office manager for review, this step is sometimes overlooked because of distractions in the office. Additionally, during the principal's vacation in August, a council member who is authorized to sign checks in the principal's absence failed to obtain dual signatures for three of the four checks that were written for more than \$1,000. The principal wrote the fourth check, but wrote it while away from the school site and therefore was unable to obtain a second signature. To ensure that New West does not overlook the dual signature requirement in the future, the principal told the audit team that she now flags each check needing the office manager's signature. However, until the charter school follows its own procedures, New West is not adequately safeguarding itself against improprieties.

Controls Over Cash

Sound internal controls are particularly important in collecting, safeguarding, and recording cash and checks. Sound internal controls over the cash receipt function include the following:

- ▶ Written policies and procedures covering the cash receipting process.
- ▶ Segregation of duties.
- ▶ Management monitoring.
- ▶ Qualified and properly trained staff.
- ▶ Timely deposits.

Organizations should clearly define and document procedures for collecting, recording, authorizing, depositing, and reporting cash transactions and should indicate who is responsible for performing duties, and when and how to perform the duties. As discussed earlier, dividing key duties and responsibilities among different staff members, —including segregating the responsibilities for authorizing transactions, processing and recording transactions, and reviewing transactions—is important for any organization.

Small organizations such as New West have difficulty in segregating duties because of the limited number of individuals available to perform tasks. The lack of personnel necessitates the implementation of additional controls such as conducting surprise cash counts on a periodic basis, utilizing a cash receipts register, and investigating deposit variances at least monthly. Having properly trained staff is another important part of sound internal controls. Training employees to know and address what their responsibilities are, and who should approve their work, helps ensure that staff members perform tasks properly, and minimizes the chance for errors or irregularities. Making timely deposits helps reduce the chance of significant losses by preventing the accumulation of large amounts of cash.

Summary of A&I Audit Findings for Fiscal Year 2003-04 (Observations 1, 3, and 7)

New West Had Several Weaknesses in Controls Over Cash

The A&I audit contained several findings regarding the school's controls over cash. These findings include:

Lack of Separation of Duties. The A&I auditors noted that New West's office manager was responsible for receiving cash, preparing cash deposits, and transporting the deposits to the bank with little or no management monitoring. In addition, the auditors had concerns about the New West council chair having unmonitored check-signing authority.

Debit Cards Not Adequately Safeguarded. Although New West's debit cards were supposed to be secured at the school when not in use, the A&I auditors found that both the school's principal and office manager carried their cards with them at all times. Moreover, use of the cards did not require any advance authorization. As a result, one person made inappropriate purchases at Disneyland.

Other Control Weaknesses. The auditors also reported that New West used four checking accounts and two savings accounts. While the auditors considered the number of bank accounts acceptable, the lack of control over the accounts raised concerns. Specifically, their audit testing found 15 checks that individuals wrote to themselves for expense reimbursements. The auditors also found that parent volunteers, having sole access to the fundraising checking account, wrote five checks that were payable to "cash."

Status of New West's Corrective Action as Determined by the Audit Team

New West Updated Its Fiscal Procedures Manual and Conducted Training for Staff

As a result of the A&I audit, New West updated its Fiscal Procedures Manual to comply with the A&I audit recommendations and then conducted training for all staff to ensure they understood the new policies. New West first implemented written guidelines for its cash receipts processes in April 2005 and then updated the guidelines in July 2005. The Fiscal Procedures Manual requires, among other things, that all transactions involving deposit of cash and checks are witnessed by two people (dual review), that all receipts are kept in a lockbox, and that staff make all deposits within seven days of collecting fundraising cash or checks from volunteer events. The audit team reviewed New West's new Fiscal Procedures Manual and found that it was clear, and contained adequate procedures for ensuring sound internal controls when followed.

Moreover, all central office staff attended training for these procedures in April 2005 and refresher training in July 2005. During audit team interviews, the office manager and staff exhibited familiarity with the policies and indicated that they understood the procedures as well as the importance of having an adequate separation of duties.

New West is More Timely in Making Deposits, but Does Not Consistently Make Deposits Within Seven Days as Its Procedures Require

New West receives cash and checks for a variety of purposes including student payments for items such as physical education uniforms, field trips, lunch, and special events. The school holds many fundraisers for which parent volunteers collect cash and checks that they submit to the school's office manager for deposit. In addition, the school receives miscellaneous cash receipts for reimbursements and donations. The office manager is the primary person responsible for ensuring that New West properly documents cash and checks and securely stores and deposits the items. In response to the A&I audit, New West developed procedures to improve its controls over receiving and depositing cash and checks. Among other requirements, the procedures call for dual review and verification of all transactions involving cash receipts and require staff to make all bank deposits for fundraising within seven days of receipt. However, the audit team found that New West does not consistently follow or enforce its policy for depositing checks.

A review of 21 bank deposits dated between July 2004 and June 2005 revealed that although New West is showing improvement, the school does not consistently meet the "seven day" deposit policy. Because New West does not keep cash or check receipt logs, the audit team had to rely upon the date of the checks to determine the length of time from receipt to deposit. Exhibit 2d provides a summary of the deposits reviewed. The average time New West took to deposit checks decreased from 31 to 10 days after New West implemented its seven-day policy. This is a marked improvement; however, it is still three days longer than the time specified in the Fiscal Procedures Manual. A few of the most lengthy deposit times included a \$400 deposit dated January 20, 2004 that took 174 days before being deposited; a \$3,158 deposit dated September 21, 2004 that took 27 days; a \$295.21 deposit dated November 3, 2004 that took 65 days; and a \$35 check dated May 5, 2005 that took 29 days.

Exhibit 2d Summary of New West's Average Days to Deposit Checks July 2004 through June 2005

Number of deposits tested	21
Average Number of Days to Deposit – Total Sample	24
Average Number of Days to Deposit – 7/12/04 through 1/7/05	31
Average Number of Days to Deposit – 4/8/05 through 6/14/05	10

Depositing cash and checks into a bank account shortly after receipt provides a higher degree of security for funds than locking the funds in filing cabinets or desk drawers. In addition, any errors that can occur are more difficult to correct with the passage of time. For organizations like New West that do not record revenues and receipts until after deposit, timely deposits result in improved financial record accuracy. Interest revenue is also lost when deposits are not timely.

New West Maintains Adequate Controls Over Bank Reconciliations and the Issuance of Its Debit Card

In response to the A&I observations and recommendations, New West implemented new and improved controls over its bank accounts by limiting the number of individuals having signature authority to three: the school's executive director, the council chair, and a parent governing council representative. It is important to note that the school's management company and the office manager do not have signature authority on this bank account. In addition, in June 2005, the school closed all bank accounts except one to make deposits and issue operating and payroll checks, and one to receive electronic transfers of revenue from the state.

In accordance with its new procedures, New West eliminated all its debit cards except one, which bears both the school's and the principal's names. The Fiscal Procedures Manual also requires that the debit card "... should be kept under locked supervision in the principal's office at all times. Any debit card is to remain on school property unless expressly required for a particular purchase by the principal." The audit team observed that the debit card was kept locked in the principal's file cabinet.

Moreover, the audit team's review of New West's bank statements, account reconciliation reports, and reconciliation processes revealed that New West now reconciles bank statements with an adequate separation of duties. New West's management company conducts the reconciliations and, as noted earlier, does not have signature authority on the account, thus providing a separation of the deposit and reconciliation functions. Bank statements, however, were not consistently reconciled on a timely basis. Specifically, the audit team found that Delta did not reconcile New West's April, May, and June 2005 bank statements until July 2005. New West should continue to conduct timely reconciliations of its bank statements to ensure it uncovers and resolves any irregularities in a prompt manner.

Controls Over Fixed Assets and Textbooks

Fixed assets represent all tangible assets owned by an organization and include equipment, furniture, buildings, land, and leasehold improvements. Adequate internal controls are necessary to ensure that an organization records its assets properly and in a timely manner, and that it protects the assets from loss by theft. Maintaining accurate, up-to-date, and detailed records is also important to ensure that periodic depreciation adjustments are reasonable and that records are sufficient for documenting insurance claims if a catastrophic loss such as a flood or fire occurs.

Controls over textbooks are important so that schools can hold the assigned teacher or student accountable for any losses or damages that occur. Detailed records that include textbook titles, original cost, condition, and the student or classroom assignment are critical pieces of information. Good controls also require periodic inventorying of books to ensure identification of losses in a timely manner so that schools can seek reimbursement from parents or teachers responsible for the textbooks' custody.

Sound controls for protecting an organization's assets include the following:

- ▶ Recording fixed assets in a timely fashion.
- ▶ Maintaining adequate identifying information such as acquisition cost, location of the asset, model and serial numbers, and estimated useful life.
- ▶ Affixing unique identification tags.
- ▶ Regular inspections of fixed assets to ensure timely identification of missing or stolen items.

Exhibit 2e shows a breakdown of New West's fixed assets as of June 30, 2004—the most recently audited records. As this exhibit shows, leasehold improvements represent the most significant portion of the school's assets. Leasehold improvements include renovations to convert the leased building space into classrooms in 2003, before the school opened. In addition, subsequent leasehold improvements include renovations to classrooms and the teachers' lounge in 2004, and remodeling to improve the library and add a media center, which New West will complete in 2005. This exhibit does not include remodeling costs incurred after June 30, 2004.

Exhibit 2e
New West's Fixed Asset Summary
(Property and Equipment)
As of June 30, 2004

Description	Amount
Equipment	\$45,981
Furniture	46,194
Leasehold Improvements	584,996
	677,171
Depreciation	(38,834)
Total	\$638,337

Source: Delta Managed Solutions.

Although New West does not capitalize textbooks on its balance sheet, the school's Fiscal Procedures Manual requires that all textbooks are labeled with an identification number, recorded, and tracked. Specifically, Section 5 of the procedures states "... an inventory must be maintained for all items with a value of \$50 or more, and for all textbooks regardless of value." The procedures allow the textbook inventory to be kept separate from the overall inventory, which New West does. Procedures further require that the inventory record include the "... asset description, location, identification tag/serial number, acquisition date, and cost...."

Exhibit 2f shows New West's textbook and reference material expenditures for the past three years.

Exhibit 2f
Schedule of New West's Textbook/Reference Material Expenditures
Fiscal Years 2003-04 through 2005-06

Description	2003-04	2004-05	2005-06 ^a	Totals
Textbooks	\$72,856	\$32,840	\$7,651	\$113,347
Reference Materials	131	2,745	188	3,064
Totals	\$72,987	\$35,585	\$7,839	\$116,411

^a Through September 9, 2005.

Source: Delta Managed Solutions.

As these exhibits illustrate, New West spends a significant amount of money for assets and textbooks. The value of the assets increases the importance of having sound internal controls to safeguard them.

Summary of A&I Audit Finding for Fiscal Year 2003-04 (Observation 2)

New West's Fixed Asset Controls Were Inadequate

At the time of the A&I audit, New West did not have a detailed listing of the school's assets, did not conduct periodic inspections to verify the existence of assets, and did not inventory its assets. The audit states "... the school did not maintain pertinent information such as: asset descriptions, acquisition dates, serial numbers, asset numbers, acquisition cost by asset, and accumulated depreciation by asset." Additionally, New West did not use identification labels, which are used to provide identifying asset inventory numbers and to tag the equipment as school property, for any of the equipment.

The school's June 30, 2004 year-end regular external audit reported similar concerns. The auditors reported that even though New West did not have a fixed asset program, the auditors were able to reconcile fixed assets to invoices on a test basis without exception.

Status of New West's Corrective Action as Determined by the Audit Team

New West Implemented a Fixed Asset and Textbook Inventory Tracking System and Procedures

After the completion of the A&I audit, New West added fixed asset procedures to its Fiscal Procedures Manual and inventoried and recorded its fixed assets. The manual now requires that staff prepare two sets of asset records: (1) a fixed asset register for capitalized assets, which are balance sheet assets having a value of \$1,000 or more and that are depreciated over time; and (2) an inventory record for all assets with a value between \$50 and \$999 and all textbooks, regardless of their value. The audit team verified that New West maintains a fixed-asset register, an inventory record, and textbook records. New West currently maintains these asset records in electronic spreadsheets. The manual calls for updating the spreadsheets as New West purchases items and for sending the spreadsheets to Delta who updates the general ledger with new items. Furthermore, its procedures call for conducting an annual physical inventory count and for reconciling the spreadsheets and the general ledger to the inventory count.

The audit team found that New West is now following adequate control procedures for its assets. Specifically, it updates the spreadsheets and general ledger in a timely manner, includes detailed information about the assets, and tags each asset with a unique identification number.

New West should be able to improve the simplicity and accuracy of its asset tracking by utilizing a system designed specifically for tracking assets. Fixed-asset systems are readily available and affordable. When properly interfaced with the main accounting system, these systems can eliminate the need for double entries; automatically calculate depreciation; simplify and standardize the recording of asset acquisitions, transfers, and retirements; and can help to ensure accurate reconciliations between the fixed-asset register and the general ledger.

In addition, bar code scanning software is now readily available to supplement the asset inventory process. Bar code scanning software utilizes bar code tags placed on furniture and equipment for scanning during the inventory process, thereby eliminating the manual counting and identification process. Bar code scanning systems have the further advantage of making it more difficult to record a missing asset as accounted for since the inventory process requires the scanning of the tags in order to include items in the inventory count. In contrast, electronic spreadsheets generally have limited security functions, can be easily altered, and do not leave an audit trail. Although Delta helped New West purchase a bar code fixed-asset scanning system in September 2004, New West is not using the scanning system because the bar coding and scanning functions do not work properly. However, as noted above, fixed-asset systems can improve the ease of tracking and controls over assets.

New West Determined that it had Several Missing Items Upon Completion of Its Inventory Count of Fixed Assets

Upon inventorying its fixed assets during the summer of 2005, New West identified 10 missing items. School staff researched these items and pursued asset recovery when possible, resulting in the return of one laptop computer and a determination that four items were broken and discarded. However, as of October 2005, five items remained missing, four computers and a computer monitor. According to New West's office manager, one computer was stolen, and the thief was seen on the school's security cameras. Additionally, a school employee claimed that a former teacher did not return a laptop computer; however, the school was unable to locate the former teacher to pursue recovery of the laptop. The school staff does not know what happened to the other three missing items. These losses, which occurred while New West was without an inventory-tracking system, illustrate the importance of having such a system to facilitate timely identification of losses. With its new procedures and systems in place, New West has reduced the likelihood of further losses.

New West's Asset Tracking Systems are Working as Designed

To test the adequacy of the fixed-asset procedures and the accuracy of the fixed-asset register, the audit team selected a judgmental sample of assets from the school's asset listing and traced these to the physical item. The audit team targeted 40 computers and high-dollar items for the sample, but also included 10 items having nominal values. In addition, the audit team also selected a sample of eight items and traced them back to the fixed-asset register. Although a few items were not in the location designated on the fixed-asset listing (one DVD/VCR player, one TV stand, one external hard drive, one notebook computer, and one microwave), the audit team was able to locate all items in the sample and all physical items selected traced back to the fixed-asset register.

Recommendations

To improve its controls over purchasing and disbursements, New West should:

- Fully implement and monitor its procedures requiring the use of purchase orders and requisitions for purchases, original invoices prior to making payments, and receiving reports with dual signatures for goods received.
- Promptly investigate and resolve all items not in compliance with New West's fiscal procedures.
- Closely monitor and control the use of its debit card and promptly investigate any deviations from its procedures.
- Implement a policy for receipt of goods during school closures to ensure delivery of all school purchases to the school.
- Revise its policy requiring dual signatures on checks greater than \$1,000 to require dual signatures on all checks.

- Notify the bank of its policy requiring dual signatures on all checks.

To improve its controls over cash, New West should:

- Maintain a log of cash and checks received and deposit all cash and checks within seven days of receipt.
- Conduct surprise cash counts periodically to ensure staff receive and record all cash promptly and accurately.
- Ensure it completes bank reconciliations in a timely manner.

To improve its controls over its fixed assets, New West should:

- Consider implementing electronic fixed-asset and textbook tracking and inventory systems.
- Implement a checkout system for portable equipment to track the user and location of the asset.
- Follow its policy for conducting annual physical inventory counts.

CHAPTER 3: NEW WEST'S FISCAL VIABILITY

Overview of School Financial Management

Generally accepted accounting principles require not-for-profit schools to prepare three types of financial statements: the Statement of Financial Position, the Statement of Activities and Net Assets, and the Statement of Cash Flows. The first two statements focus on assets, liabilities, revenues, and expenses. The Statement of Financial Position reports the assets, liabilities, and changes in net assets (difference between assets and liabilities) of a school. The Statement of Activities reports the ending net assets or “reserve” for a school. California Code of Regulations Section 15443 sets different target net assets (reserves) for school districts based on their student average daily attendance (ADA). Specifically, this section states that “... available reserves cannot be less than the following percentages as applied to total expenditures, transfers out and other use...:

- ▶ The greater of 5 percent or \$50,000 for districts with 0 to 300 ADA.⁵
- ▶ The greater of 4 percent or \$50,000 for districts with 301 to 1,000 ADA.
- ▶ Three percent for districts with 1,001 to 30,000 ADA.
- ▶ Two percent for districts with 30,001 to 400,000 ADA.
- ▶ One percent for districts with 400,001 and over ADA.

The agreement between the State Board and any charter school it approves requires that charter schools follow these guidelines, though the reserve targets are not legally mandated.

Reserves represent a measure of financial resources available for future use after all obligations have been met. Reserves are one of the primary measures of solvency for an entity such as a school and are viewed as an important measure of financial condition. However, reserves do not necessarily represent cash because they may involve revenues and expenses recorded on the books, but not yet received or paid. Rather, the amount of cash on hand could be higher or lower depending upon whether the entity has larger amounts of accrued revenues or expenses/liabilities.

The third required financial statement, the Statement of Cash Flows, measures the cash on hand at a point in time. It traces the flow of funds (or working capital) into and out of an entity during an accounting period. The Statement of Cash Flows can be useful in assessing the following:

- ▶ Ability of an entity to generate future cash flows.
- ▶ Ability of an entity to pay its debts as the debts mature.
- ▶ Need to seek outside financing.
- ▶ Reasons for differences between cash flows from operations and operating income.

- ▶ Effect on an entity's financial position of cash and noncash transactions from investing, capital, and financing activities.

Cash management is important for any entity, especially new or relatively new organizations such as New West that may not have had time to establish sufficient cash reserves. Cash management is ultimately about cash flow and anticipating or planning for when an organization will receive cash and need to use cash. Prudent financial management requires accumulating sufficient cash to cover cash outflows that might otherwise leave a negative balance. The following highlights some basic tenets about managing cash flow:

- ▶ Make financial projections. Forecast both expenses and anticipated revenues for at least the coming year and maintain a cash reserve if possible.
- ▶ Create contingency plans. Have several budget projections including best-and worst-case scenarios and lay out how the organization would respond.
- ▶ Monitor expenditures. Try to get as much value as possible out of every transaction.
- ▶ Keep inventories low. Only stock for short-term needs.
- ▶ Delay hiring some employees until the revenue is available to support those employees.
- ▶ Do not be wasteful. Reuse what you can.

Following these basic tenets and monitoring the Statement of Cash Flows can help an entity to ensure it has adequate cash to meet its ongoing obligations.

Summary of A&I “Other” Audit Finding for Fiscal Year 2003-04

Cash Flow Loans Cause Concern About New West's Financial Viability

The A&I auditors reported concerns about New West's cash flows and its ability to continue to effectively operate as a viable charter school. Specifically, the A&I auditors had concerns about three cash flow loans New West procured and three comments made in a school newsletter. The comments, in the context of soliciting contributions from student families, were as follows:

“We are in immediate danger of having to cut back or cut out some of our enrichment programs at New West.”

“Our budget is based on the fact that we need to raise \$2,500 per student in able to provide these programs. The State gives us basic funds for our core subjects and support materials like textbooks. But they don’t provide the funding for these other things. So, we must rely on fundraising, grants, and gifts to make up that \$2,500 per student difference.”

“We must raise \$100,000 by June.”

These items were outside the A&I’s initial review period and as such, the audit requestors asked FCMAT to look into the cash flows and ongoing viability of New West.

Moreover, New West’s FY 2003-04 external auditors noted that “...although New West is financially stable, its financial condition is highly dependent upon the economic condition of the State of California.” The auditors noted two factors that could negatively affect every public agency including New West: the state’s budget deficit and the continued rising costs of insurance.

Status of New West’s Corrective Action as Determined by the Audit Team

New West’s Limited Cash Reserves Make it Vulnerable to Insolvency If Circumstances Change

New West’s historical and projected cash reserves appear to provide only a limited cushion for contingencies. Limited cash reserves can become problematic if there is an interruption or reduction in revenues or if unexpected expenses arise.

Exhibit 3a (please see the following page) presents a comparison of New West’s audited cash flows for FY 2003-04, unaudited cash flows for FY 2004-05, and projected cash flows for FY 2005-06. This cash-flow statement has three categories, cash flow from operating, investing, and financing activities. The statements reveal limited cash reserves each year, with a FY 2005-06 projected reserve of less than two weeks’ worth of average expenditures. As Exhibit 3a shows, New West’s cash limitations are directly attributable to its investing and financing activities, which mostly account for costs of and loans for New West’s extensive renovation of its school site to meet code requirements and to make the school suitable for the students. New West’s operating activities appear to be providing an adequate cash flow to support these renovations but leave the school with minimal cash left over.

Exhibit 3a
New West's Cash Flow Statements
Fiscal Years 2003-04 through 2005-06

	Fiscal Year		
	2003-04 Audited	2004-05 Unaudited	2005-06 Unaudited Projections
Cash Flows From Operating Activities			
Increases (decreases) in net assets	\$124,578	\$(51,154)	\$126,898
Adjustments to reconcile net income to net cash provided by operations:			
Accounts Receivable	(45,463)	(42,648)	8,111
Grant Receivable	-	(20,000)	-
Depreciation	38,834	72,543	73,031
Accounts Payable	83,705	3,629	(3,724)
Accrued Payroll	107,262	15,425	-
Deferred Revenue	9,521	(9,521)	-
Payroll Liabilities	-	86,237	(32,428)
Note Payable	90,000	-	-
Other	-	(7,752)	(5,755)
Net Cash Provided By Operating Activities	408,437	46,759	166,133
Cash Flows From Investing Activities			
Fixed Assets - Leasehold Improvements	(677,171)	(14,002)	-
Fixed Assets - Library	-	(1,125)	(17,467)
Fixed Assets - Equipment	-	(8,555)	(3,500)
Fixed Assets - Furniture	-	(4,592)	(2,513)
Net Cash Used In Investing Activities	(677,171)	(28,274)	(23,480)
Cash Flows From Financing Activities			
Nowa Derm Loan	100,000	-	-
Repayment of Nowa Derm Loan	(100,000)	-	-
Eagles Peak Charter School Cash Flow Loan	-	50,000	(50,000)
Founder's Loan (Eagle)	-	(214,950)	-
Pacific Western Rollover Loan	-	165,750	(39,000)
State Revolving Fund Loan	250,000	(50,000)	(50,000)
Net cash provided by financing activities	250,000	(49,200)	(139,000)
Net cash increase (decrease) for period	(18,734)	(30,715)	3,653
Cash at beginning of period	84,818	66,084	35,369
Cash at end of period	\$ 66,084	\$35,369	\$39,022

Sources: Feddersen and Company, LLP, Certified Public Accountants (FY 2003-04) and Delta Managed Solutions (FY's 2004-05 and 2005-06).

According to Delta's financial officer, he expects that this situation will continue for three more years until the school has paid off the renovation debts. In the meantime, it will be important for New West to closely monitor and manage its cash to ensure it has adequate funds to deal with contingencies, missed projections, or unforeseen operating needs. This is of particular importance since New West has been unable to obtain a business line of credit to help deal with temporary cash shortages.

New West Lacks Written Policies for Cash Management

The audit team also found that New West does not have written policies for cash-flow management and budgeting, cash-flow contingency plans, or adopted cash reserve goals. Delta's financial officer explained that New West and Delta are moving forward with debt and cash-flow management plans and that he expects the council will complete and adopt the plans by the end of 2005. However, given the school's limited cash reserves and resources, effective planning and monitoring are essential to avoid or mitigate potential problems. Until it documents and follows its cash-flow policies, contingency plans, and cash goals, it will be difficult for the school to ensure it is managing its cash as effectively as possible.

New West's Reserve Balance Dipped, but Shows Recovery in Coming Year

In addition to analyzing the school's cash-flow projections and policies, the audit team also considered New West's net asset or "reserve" balances. The school's reserve fell below the state's recommended reserve balance in FY 2004-05, but shows signs of improving in FY 2005-06.

As illustrated in Exhibit 3b, New West was able to end FY 2003-04 with a 5.9 percent reserve, or \$104,446, more than five times the level of its reserve in its first year of operation (FY 2002-03). Its FY 2003-04 reserve exceeded the state's recommended reserve levels of 5 percent of expenditures or \$50,000, whichever is greater. However, in FY 2004-05, the school's reserve decreased to \$53,292, or 2.8 percent of expenditures, a 49 percent drop from FY 2003-04 and just over one-half the assets-to-expenditures ratio recommended by the state. Delta's financial officer attributes this drop to its repayments of loans taken to pay for renovating the school.

Exhibit 3b

**New West's Statements of Net Assets
Fiscal Years 2003-04 through 2005-06**

Description	2003-04 Audited	2004-05 Unaudited	2005-06 Projected
State Aid Portion of General Purpose Block Grant	\$725,798	\$954,550	\$1,109,918
Other State Revenue:			
Categorical Block Grant	35,318	79,398	87,495
Implementation Grant	380,000	20,000	0
All Other	6,035	172,826	148,508
Federal Revenue:	0	2,922	3,000
Local Revenue:			
Cash in-lieu-of Property Taxes	414,870	335,898	355,823
All Other	99,952	111,207	115,944
Other Revenue:			
Contributions, Fundraising, and Related Activities	231,565	154,921	135,000
Interest Income	2,081	692	1,250
Total Revenues	1,895,619	1,832,414	1,956,938
Program expenses	1,622,122	1,728,673	1,646,264
Management & administrative expenses	148,919	154,895	183,776
Total Expenses	1,771,041	1,883,568	1,830,040
Change in Net Assets, increase/ (decrease)	124,578	(51,154)	126,898
Prior Year Net Assets (deficiency)	(20,132)	104,446	53,292
End of Year Net Assets/Reserve - Unrestricted	\$104,446	\$53,292	\$180,190
Percent of Net Assets To Expenditures	5.9%	2.8%	9.8%

Sources: Feddersen and Company, LLP, Certified Public Accountants (FY 2003-04) and Delta Managed Solutions (FY's 2004-05 and 2005-06).

New West's projected reserve levels for FY 2005-06 show a marked increase from FY 2004-05, an increase of almost \$127,000 in its year-end balance and one that represents 9.8 percent of expenditures. Delta's financial officer attributes the significant projected reserve increase to larger revenues resulting from higher student attendance and savings and cuts in operational expenses, such as cuts in legal expenses, savings from bringing arts and music programs in-house, and savings in telecommunications consulting costs. Exhibit 3b shows the expected increase in FY 2005-06 program revenues from student attendance, an increase of more than \$140,000 from FY 2004-05. According to Delta's financial officer, as of early November 2005 ADA levels were matching projections for enrollment.

Given that the student enrollment increases are consistent with projections thus far in FY 2005-06 and that New West is making concerted efforts to contain and reduce expenses, it is reasonable to assume that the school will realize a larger reserve in FY 2005-06 than in

FY 2004-05, and one that exceeds the recommended five percent threshold. The true test for New West will be whether it can continue to exceed the recommended reserve in the out-years.

The Assumptions Behind New West's Cash-Flow Projections Seem Reasonable

The audit team reviewed the assumptions New West used to prepare its cash flow projections and found that the assumptions appear reasonable. These assumptions include projections regarding the timing of revenue streams and payment of expenditures, anticipated salary increases, local fund-raising efforts, and student ADA. As the comparisons in Exhibits 3a and 3b show, the increase in net assets in FY 2003-04 was \$124,578, but for FY 2004-05, the school anticipates a decrease in net assets of \$51,154. This is due primarily to New West's focus on reducing the debt load taken on during its initial years of operations and for renovations. Specifically, in FY 2003-04, the school took on \$250,000 in debt, and in FY 2004-05, it decreased its net debt load by \$49,200. Analysis of FY 2005-06 projected cash flows shows that the school anticipates a further reduction of its debt by \$139,000, while projecting that its net assets will increase by almost \$127,000. These FY 2005-06 projections result in a projected ending net cash balance of \$39,022 by the end of FY 2005-06. These projections appear realistic if the school can meet its projected student ADA levels.

Exhibit 3c shows the school's ADA levels for FY 2003-04 and FY 2004-05, along with a projection of FY 2005-06 levels.

Exhibit 3c
New West's Student Average Daily Attendance Levels
Fiscal Years 2003-04 through 2005-06

Year	ADA	Percentage Increase from Prior Year
2003-04	242	n/a
2004-05	266	10
2005-06	285 ^a	7

^a Projected.

Source: Delta Managed Solutions.

The increase in the ADA projection seems reasonable, given that the principal told the audit team the school lost many students last year due to the instability of administrative leadership and that New West has largely eliminated the issues that caused parents to take their children out of the school.

RECOMMENDATIONS

To improve its cash position and cash management abilities, New West should:

- Strive to accumulate cash reserves of at least one full payroll and continue its efforts to secure a revolving line of credit for contingencies.
- Establish and adhere to written policies for cash-flow management and cash budgeting, including a cash-flow contingency plan.

CHAPTER 4: CONTRACTING PROCESSES

Controls Over Contracting

In the course of educating its students, New West finds occasional needs to contract for services that it does not have the expertise, workers, or equipment to perform. Sound contracting procedures require the following:

- ▶ Organizations obtain multiple bids to better ensure they obtain the highest quality goods or services at the best cost.
- ▶ Contracts are properly executed, including a review by a lawyer if necessary.
- ▶ Contracts include a detailed scope of work and price to prevent misunderstandings.
- ▶ All contract modifications or changes are made in writing.
- ▶ A governing council approves certain contracts meeting specific criteria.
- ▶ The terms of the contract are properly managed to ensure that the entity is receiving the services paid for under the terms of a contract.

Summary of A&I Audit Finding for Fiscal Year 2003-04 (Observation 5)

New West Had Little or No Controls Over Its Contracting Practices

The March 2005 A&I audit found that New West did not receive competitive bids or have a clearly defined scope of work for several significant contracts relating to construction work at the school. Although New West staff members told the A&I auditors that they obtained several bids, the bids were verbal with no written documentation to support the bidding process.

Status of New West's Corrective Action as Determined by the Audit Team

New West Developed But Does Not Fully Comply With Its Contracting Procedures

New West recently developed new contracting procedures; however, the audit team found that the school could improve these procedures and did not follow its procedures in two of the eight contracts reviewed. Well-designed contracts and contracting procedures help to minimize the risk of misunderstandings and disputes over contract terms that could result in costly losses or litigation.

To test compliance with New West's contracting procedures, the audit team tested several contracts to determine if the following requirements had been met:

- ▶ The contract was complete with terms, expectations, and price clearly spelled out.
- ▶ The council approved the contract, if applicable.
- ▶ All parties to the contracts fulfilled their responsibilities.
- ▶ The executive director signed the contract.

New West's new Fiscal Procedures Manual also contains its contracting and purchasing procedures, which require the school to obtain competitive bids "... where required by law or otherwise deemed appropriate and in the best interests of the school." These procedures allow the executive director to negotiate and execute all contracts. In addition, the executive director may execute contracts of less than \$5,000 before council ratification, but the council must ratify contracts of \$5,000 or more prior to execution by the executive director. These procedures also require a complete and detailed scope of work and price for each contract.

The audit team found New West's written procedures for executing contracts to be inadequate. Specifically, the procedures are silent with regard to the monitoring of contracts to ensure all parties fulfill their responsibilities. In addition, New West's procedures do not require staff to document competitive bids obtained or to document the need for the product or service obtained.

The audit team also found that New West does not consistently follow its procedures. In addition to the facility lease for the main school complex, New West entered into an agreement for the use of space near the school. New West used the space for elective classes and based the lease payments on an estimate of the hours of monthly use. The audit team found that the council did not vote to approve the contract; however, New West entered into the contract prior to establishing its policy requiring the council to ratify all contracts. Following the lapse of this lease agreement in June 2004, the audit team found that the school continued to use the space through March 2005 without a formal agreement in place. New West made no payments for the use of this space during this period. Delta's financial officer explained that there was no formal agreement in place because the school and the property owner could not agree on the terms. The property owner wanted to increase the lease price. The financial officer explained that a New West parent volunteer who felt a reduced lease fee could be negotiated offered to address the proposed payment with the landlords. However, the parent was unsuccessful, and New West did not enact a new agreement. As a result, in March 2005, the property owner submitted an invoice to New West based on the increased rate it initially proposed, and New West made payment at this increased rate.

Other issues arose with the adjacent space that New West may have been able to avoid or mitigate by using proper contracting procedures. Specifically, the property owner assessed New West for damages purportedly caused to the property by New West

parents and students. Over the 19-month period in which New West used the facilities, the property owner charged the school \$5,488.47 for damages and failed to return New West's \$5,000 deposit. The following are two examples of the property owner's charges. In correspondence dated April 2004, the property owner claimed that students damaged the top of a piano by using it as a writing surface. The property owner charged, and New West paid, \$1,200 for refinishing the piano's surface. In addition, the property owner charged New West for the cost of cleaning and relocating the piano. Because of the lack of a contract during the end of the lease term and because the original contract did not contain adequate details about how New West should maintain and utilize the property or how the landlord would handle the deposit, the audit team could not determine whether the additional charges paid by New West were reasonable.

Moreover, upon review of documents related to New West's five-year lease agreement for its school site, the audit team found that New West did not make full lease payments for eight of the first 12 months of the lease term. Delta's financial officer explained that New West and the property owner verbally agreed to this payment reduction in exchange for New West paying for needed air-conditioning repairs. However, without a written contract modification, the audit team cannot verify the validity of the agreement, and New West exposes itself to unnecessary disputes over the verbal terms. Furthermore, unwritten contract modifications are not a part of sound contracting procedures as previously discussed and could potentially result in disputes.

RECOMMENDATIONS

To improve its contracting practices, New West should update its contracting procedures to require:

- Contract monitoring to ensure all parties fulfill the terms of contracts.
- Staff to maintain documentation in the contract file evidencing the competitive bids obtained and the justification of need.
- Staff to make all contract modifications in writing and prohibit initiation of services or continuance of a contract until the contract is properly executed, including prior governing council authorization.

CHAPTER 5: GOVERNANCE

Overview of Governing Council

New West's governing council includes 14 members who act as the chief decision-making authority for the school. The council members include eight voting members who are not employees of the school and six nonvoting members who are school employees. The governing council positions include:

Principal (Nonvoting). The governance council appoints the school's principal.

Three Parent Representatives (Voting). Parents whose children attend New West elect three parent representatives and two alternates. They elect two representatives and one alternate in odd-numbered years and one representative and one alternate in even-numbered years. The parent representatives serve two-year terms.

Three Founder Representatives (Voting). New West's founding parents elect three founder representatives and two alternates with one representative and one alternate elected in odd-numbered years and two representatives and one alternate elected in even-numbered years. The founder representatives also serve two-year terms.

Three Teacher Representatives (Nonvoting). New West's full-time credentialed teachers elect three teacher representatives and two alternates with one representative and one alternate elected in odd-numbered years and two representatives and one alternate elected in even-numbered years. Teacher representatives serve two-year terms.

Staff Employee Representative (Nonvoting). New West's full-time noninstructional employees elect one staff employee representative and one alternate. The staff employee representative serves a two-year term. Normally, the staff representative is elected in odd-numbered years and the alternate is elected in even-numbered years.

Two Community Representatives (Voting). The governing council also appoints two community representatives and one alternate from a list of volunteers who express an interest in the school. One representative must have experience in education and the other experience in business, and the alternate can have a background in either. These representatives cannot be founders, parents of children attending New West, or employees of the school.

Oversight Representative (Nonvoting). The State Board, as chartering authority for New West, has the right to designate a monitoring agent to the governing council.

New West's council is responsible for managing the school and has sole authority for all aspects of the school's operation and educational program including, but not limited to, the development and implementation of policies related to curriculum, enrichment

and extracurricular educational activities, student evaluation, personnel, professional development, budget and finance, facilities and maintenance, admissions, scheduling, community relations, classroom usage, use of the school site, safety, discipline, proposals for charter revision and renewal, dispute resolution, and interactions with the chartering authority and other educational agencies. The New West's Corporate Bylaws govern the council's operations and actions. The council appoints and employs the principal and vests that person with the authority to hire employees, work with volunteers, establish school policies, and take actions as necessary to operate the school in accordance with the school's charter.

New West also maintains an executive committee that works along with the council to conduct the school's business. The chair of the council, the principal, and one teacher elected each year by the teacher governing council representatives make up the executive committee. Responsibilities of the executive committee include the following:

- ▶ Setting council meeting agendas.
- ▶ Handling routine matters that do not require the attention of the full council.
- ▶ Referring issues to the council.

New West's Charter requires that the school have a written policy to limit actual or potential conflicts of interest. The charter states that the conflict-of-interest policies are to apply to governance council members, committee members, administrators, teachers, staff, parents, community members, and any other person or party who participates in the school's operation and educational program, all of whom should be asked in writing to uphold the policy. The charter further specifies four essential elements that the conflict-of-interest policy should contain the following:

Full Disclosure. Stakeholders shall make known any potential or actual conflict of interest.

Abstention from Discussion and Decision-Making. Stakeholders who have an actual or potential conflict of interest shall not participate in discussions or votes on matters related in any way to the area of conflict.

Abstention from Decision-Making. Stakeholders who have an actual or potential conflict of interest shall not be substantively involved in decision-making on matters related in any way to the area of conflict.

Violation of Policy. Anyone can report violations of the conflict-of-interest policy and shall be referred to the school's dispute resolution procedures.

Summary of A&I Audit Findings for Fiscal Year 2003-04 (Observations 6 and 9)

New West's Governing Processes Did Not Ensure Integrity

The A&I audit pointed to two weaknesses found in the school's governance procedures. First, the A&I audit pointed to irregularities in the governing council's election process. Specifically, New West's governing council did not ensure the integrity of ballot counting during the October 2003 council elections by allowing a governing council candidate to count the ballots by which the candidate was elected as a founder representative. Second, the school engaged in several related-party contracting agreements and arrangements. The auditors considered these practices improper and reported that they could potentially lead to opportunities for misappropriation of funds or personal gain for the related parties.

In response to the A&I audit, the Department's Notice to Cure requested documentation from New West related to New West's governance. Specifically, the Notice to Cure requested that New West provide the following:

- ▶ Written policies and procedures delineating the governing council selection process to ensure that individuals running for election are not a part of the vote-tallying process, and to provide evidence that New West implemented the new policies and procedures.
- ▶ Evidence of a written conflict-of-interest policy that includes full disclosure, abstention from discussion, and abstention from decision-making requirements if a related-party transaction exists.

The A&I audit also found that the school's governing council engaged in activities that could be deemed conflicts of interest. Specifically, the audit identified the following three primary transactions that led to this finding:

- ▶ The governing council did not ratify a \$300,000 loan dated April 2002 to New West from one of the original founders. This loan was made before the school had a governing council, and although the loan was later ratified by the school's governing council and subsequently refinanced through a bank loan, the repayment practices for the original loan were deemed questionable by the A&I auditors. In order to loan the money to New West, the founder took out a mortgage line of credit. Rather than having the school make loan payments to the founder, New West made payments directly to the mortgage company that issued the line of credit.
- ▶ During 2003, New West again borrowed money, free of interest, from a parent having a child in attendance at the school. New West repaid the \$100,000 loan five months later. However, the A&I auditors reported that the parent's business granted the original loan, yet the school made the check for the loan repayment payable to the parent.

- ▶ During 2004, the school's financial management company, Delta, granted a \$2,000 interest-free loan to the school to meet short-term obligations. The A&I auditors questioned the apparent close relationship between Delta and New West.

Status of New West's Corrective Action as Determined by the Audit Team

New West's Governing Council Has Adopted and Implemented Election Procedures

During October 2005, the audit team visited New West to observe its process for tallying the ballots for the election of founder representatives to the governance council. The audit team found that the process used to tally the votes was in accordance with New West's election procedures.

On June 10, 2005, the governing council passed a resolution that authorizes and approves the Governing Board Selection Process policy. The election procedures detail the membership of the governing council and define eligibility requirements for allowing an individual to run for an office, and define voting eligibility. The procedures also describe the voting system, election and voting processes, and requirements for posting election results.

As described in the election procedures, the voting system is cumulative, allowing each voter a number of votes on each ballot that totals the number of representatives plus alternates to be elected. Under this system, the voter may choose to cast more than one vote for a candidate, limited to the total number of votes allowed on the ballot. The candidate(s) receiving the highest number of votes is (are) elected as representative(s) and the candidate(s) receiving the next highest number of votes is (are) elected as the alternate(s).

Counting procedures for parent and founder elections require storage of ballots in a locked ballot box until the official opening and tallying. Further, the principal is to monitor the opening and tallying of ballots together with at least two witnesses who are not candidates and are not related to candidates in the election. In addition, the procedures call for maintaining all ballots in a secure location for two years. Teacher and staff elections take place during an election meeting in which the principal counts secret votes during the meeting.

In observing the founder election, the audit team found that the vote count began at the stated time with four New West staff members; the principal, the office manager, and two office assistants; conducting the count. No one from outside the school attended to observe the process. To ensure all the ballots were counted accurately, the New West staff conducted two tallies. First, the two office assistants removed envelopes containing the

votes from a sealed box where they had been stored and divided the envelopes between each of them. Each office assistant then opened envelopes one by one and called out the names of the candidates on the ballot. The principal tracked the number of votes received for each candidate on a large white board. After conducting the first count, the office assistants traded envelopes and repeated the process, this time with the office manager tallying the votes on the white board. Each count returned the same results. Moreover, the audit team asked to view the ballots from prior elections to ensure New West was safeguarding the ballots and found that New West kept the old ballots in a locked file cabinet. Overall, the audit team found New West's processes for counting and securing election ballots to be reasonable for ensuring an accurate and impartial result.

New West Established and Implemented Conflict-Of-Interest Policies and Procedures

In response to the A&I audit, New West readopted its conflict-of-interest code and obtained conflict-of-interest disclosures from all relevant personnel. New West will need to continue to follow its procedures as personnel changes occur to ensure adequate protection against potential unscrupulous related-party transactions.

New West originally adopted a conflict-of-interest code in May 2004. The council resolution adopting the code states that in accordance with Government Code Section 87300, which requires New West to adopt a conflict-of-interest code, the school will adopt the Fair Political Practices Commission's (FPPC) code as a model conflict-of-interest code. This code requires governing council members and certain employees to file FPPC Form 700.

In response to the A&I audit and the State Board's Notice to Cure, which requested that New West adopt a conflict-of-interest policy, New West again adopted a resolution that specifically "... authorizes and reapproves the previously approved Conflict-of-interest policy." New West's council approved and the council secretary signed this most recent resolution in June 2005. The code contains two disclosure categories for designated employees. Category 1 employees must disclose all business interests in entities engaged in activities such as accounting, banking, computers, communication, education, insurance, office equipment, personnel, printing, securities, or title. Category 2 employees must disclose any relationship to a business of the type to provide to schools: personnel, services, supplies, materials, machinery, or equipment. The code requires that voting governance council members, the principal, and the office manager disclose all interests in both categories. The audit team found that New West's principal, office manager, and voting governance council members each completed a FPPC Form 700 in August 2005 in accordance with this code.

The Audit Team Found No Evidence of Fraud or Preferential Treatment Concerning the Related-Party Transactions

The audit team reviewed the school's council minutes and banking records and did not identify any misappropriations, fraud, or preferential treatment concerning the loans from the parent founder (\$300,000), Delta (\$2,000), or a New West parent (\$100,000). This finding is discussed further in Chapter 6.

RECOMMENDATION

To ensure sound governance of the school, New West should continue its efforts to implement and adhere to the recommendations made by the A&I auditors with respect to governance and related-party transactions.

CHAPTER 6: FOLLOW-UP ON A&I'S AUDIT WORK RELATED TO FISCAL YEAR 2003-04

Overview and Conclusion

As a part of the audit, FCMAT requested that the audit team:

- ▶ Investigate and follow up on all unresolved issues from A&I's March 2, 2005 review for FY 2003-04.
- ▶ Verify and assess observations from A&I's March 2, 2005 review.
- ▶ Identify any areas of concern or misconduct, quantify any misappropriations or irregularities, and make recommendations for improvement.

(See the specific requests in italics in the following paragraphs)

As indicated below, the audit team was able to resolve many of the unresolved issues from the A&I audit; however, some issues remain unsettled. Even though the audit team did not find evidence of improprieties, the unresolved issues remain susceptible to improprieties. Until New West consistently implements adequate administrative internal controls, it cannot ensure it is adequately protecting its assets or giving itself the best opportunity to succeed.

A. Inventories

Verify that computers and other significant assets purchased by David Eagle with New West funds exist and are being utilized at New West. Reconcile the computers and other significant assets to the school's inventory listing. Trace the serial numbers appearing on the invoices to the serial numbers on the computer hardware.

The audit team obtained the Dell invoices showing the 2003 computer purchases made by David Eagle. Of the 48 computers included on the invoices, the audit team verified that New West recorded 44 of the 48 items in its fixed-asset register, resulting in a difference of four unaccounted for computers.

As discussed in the Fixed Assets section of *Chapter 2*, at the time that school staff inventoried its assets during the summer of 2005, New West found that four computers were missing; three of these computers were purchased by David Eagle. The audit team identified an additional computer purchased by David Eagle that was missing from the fixed-assets register. According to New West's records for the missing items, one computer was stolen by a homeless person⁶ and one teacher did not return his laptop. Both computers were from the David Eagle purchase. New West does not know what happened to the other two computers purchased by David Eagle; however, given

that one computer was stolen and one was not returned, it is conceivable that the other computers were unaccounted for due to similar circumstances.

The audit team also selected a sample of 19 computers to verify the accuracy of New West's fixed-assets register. The audit team was able to locate all 19 computers by tracing the serial numbers on the invoices to the serial numbers on the units, which combined with the other testing discussed in Chapter 2, indicates that all items listed in the fixed-assets register exist. The audit team also tested other large assets purchased by David Eagle including locker units, a conference table, and a digital projector. In addition, the audit team observed the existence of the school's bell system and security system. The audit team was able to locate all items selected in the sample. However, even though the audit team was able to locate all of the items in its sample, the missing items discovered by New West and the audit team indicates that the fixed-asset procedures and controls in effect at the time were inadequate.

B. Loans

Review the propriety of New West's loans and loan repayments. Specifically, review the Eagle's Peak (\$50,000), Delta Managed Solutions (\$2,000) and Nowa Derm/Chantel Burnison (\$100,000) loans by analyzing loan agreements, loan payments, and cancelled checks. If necessary, contact and interview the lender to obtain additional information. Additionally, determine the propriety of the personal loans (and repayment of those loans) made to New West by David Eagle and his parents. Furthermore, review the payments made by New West to lenders in fulfillment of David Eagle's personal financial obligations for propriety.

Loan from Eagles Peak Charter School (EPCS). The EPCS provided New West with a cash flow loan of \$50,000 on July 15, 2004. According to Delta's financial officer (who also provides financial consulting services for EPCS), EPCS had already planned to loan funds to another charter school to cover cash flow, so he put New West into contact with EPCS.⁷ Approval for entering into this transaction came from New West's governance council on July 9, 2004. Terms of the loan required New West to pay four percent interest and had an original repayment date of July 1, 2005. However, at New West's request, EPCS's governing board agreed to an extension and passed a resolution extending the due date to October 31, 2005. As of November 2005, New West had not yet repaid the loan and is seeking a further extension until April 2006. The financial officer told the audit team that the reason for the second extension is that New West will be in a more favorable cash position in April 2006 due to anticipated state funding increases for its increased ADA. The EPCS executives have verbally committed to the extension, but the EPCS board will not vote on the matter until December 7, 2005. According to the financial officer, EPCS agreed to the extension as its own cash-flow requirements are not affected by this extension and the loan bears interest similar to what it would otherwise be earning.

The audit team compared the staff and governing council rosters of New West and EPCS. Other than the financial officer, the audit team did not find any individuals working for both schools. Overall, the audit team did not find any evidence of improprieties involved in this transaction and found that both schools authorized and approved the loan and the first extension. However, New West did not gain formal EPCS board approval of either extension before the loan payment due date. This practice could become problematic if the EPCS governing board does not agree with the recommendations of its staff.

Loan from Delta. Early in 2004, Delta made an interest-free loan of \$2,000 to New West. Delta's financial officer explained that during February 2004, both Delta and the school were issuing checks from the school's bank account. On February 25, 2004, when Delta discovered that New West was at risk of overdrawing its bank account, they wired \$2,000 to the school's account to cover the amount of the cash shortfall. On March 14, 2004, New West repaid Delta the \$2,000 and an additional \$30 to cover the wire transfer fee.

Delta's financial officer told the audit team that New West obtained this loan without prior governance council approval and without committing the terms of the loan in writing because of the immediacy of the situation and because it fell within the spending authority limits of the principal. In hindsight, Delta's financial officer explained, there should have been some written agreement to document the transaction. The audit team agrees that New West should ensure it creates a proper paper trail, including the execution of a loan agreement, for all loan transactions to prevent potential misunderstandings regarding the terms of the loan.

Loan from Chantal Burnison. On July 1, 2003, New West signed a promissory note for an interest-free, short-term loan from a school parent, Chantal Burnison. The promissory note lists Ms. Burnison as the payee on the loan. However, Ms. Burnison issued a check to New West drawn in her company's name, Nowa Derm. Ms. Burnison, as the chief operating officer of Nowa Derm, signed the check to New West for \$100,000 on July 8, 2003.

On November 21, 2003, New West repaid the loan by issuing a \$100,000 check payable to Chantal Burnison as specified in the promissory note. The audit team verified that Ms. Burnison deposited the check into Nowa Derm's account.

Loan from David Eagle. In April 2002, New West entered into a multiple advance promissory note with David Eagle. Terms of the note included an interest rate set at the Prime Rate (as defined in the Wall Street Journal on the first business day of each month). Between April 2002 and July 2003, New West received draws of \$274,950 on this note. As noted in the A&I audit, this loan was never approved by the New West governance council because, as David Eagle explained, the school's first governance council elections were not held until October 2003; therefore, there was no governing

council to approve the loan. In addition, David Eagle took out personal loans to cover the loan to the school, and rather than having the school make payments to him, David Eagle had the school make payments to his lending institutions directly.

In May 2004, David Eagle issued a revised note to New West for \$219,950, with an annual interest rate of 0.375 percent over the prime rate. This revised note required the school to make monthly payments of \$5,000. New West's governance council retroactively approved the revised loan on July 9, 2004.

In August 2004, New West refinanced the Eagle note with a promissory note from Pacific Western Bank for \$195,000. The governance council approved the Pacific Western loan on July 9, 2004, prior to executing it. Governance council meeting minutes show that David Eagle recused himself from the discussions and the vote on each of these loan approvals at the July governance council meeting.

The audit team recognizes New West's need for start-up funding to ready its school site and the difficulty New West experienced in obtaining traditional funding through a lending institution. However, New West did not create a proper paper trail for this loan, which would include a waiver from David Eagle to receive direct payments and an authorization to pay his creditors directly. Though New West could have better handled the administration of the Eagle loans, the governance council has since remedied these concerns and ameliorated any appearance of impropriety by paying off the Eagle note with the proceeds from a loan with Pacific Western Bank.

C. Expenditures

Assess the propriety of questionable expenditures. Specifically:

- C.1. *Follow-up on questionable-looking or incomplete invoices to validate that the vendor exists and provided the goods/services to New West.*

The audit team followed up on the invoices that were incomplete or questionable in appearance by researching the vendors on the Internet and/or with the Secretary of State's office. The audit team also verified, where applicable, the existence of the purchased assets by vouching the assets to the fixed-asset register and physically viewing some of the assets. The audit team found that all of the vendors existed and was able to locate all items tested.

- C.2. *Review payments made by New West on behalf of other companies/ individuals, including David Eagle and David Eagle Productions, to verify that the goods/ services purchased actually benefited New West.*

Refer to sections A. and C.6. of this chapter. Where possible, the audit team tested for existence of the items, reviewed receipts and invoices, and attempted

to verify the purchases with the vendor. However, several of the payments made to credit card companies were for consumables such as office supplies and copies and the audit team was therefore, unable to verify that New West received the items. In addition, several of the items reimbursed or paid on David Eagle's behalf (as shown in Exhibit 6b) were not substantial in amount and therefore, the audit team did not attempt to verify them with the vendor. New West also could not support some payments with receipts or invoices and it was unable to identify the nature of the purchases (detailed in section C.6.). However, for the large purchases such as computers and equipment, the audit team was able to test the existence of the items purchased, as detailed in section A. of this chapter. Although the audit team did not find any evidence of improprieties, it is clear that New West's procedures and controls over expenditures were inadequate during FY 2003-04.

- C.3. *Follow-up on invoices for goods delivered to and/or services provided at addresses other than New West, such as books delivered to William Neil. Verify that New West received the goods and/or that services were rendered at New West.*

During the period that New West was renovating its school site location, vendors delivered some items such as computers and textbooks to addresses other than that of the school. The audit team's testing of fixed assets showed that New West received and is using the Dell computers (shipped to an address other than the school) with the exception of the four missing computers discussed previously. The audit team viewed the inventory of textbooks stored in classrooms and the storage area and reviewed New West's textbook register. In doing so, the audit team verified the existence of similar quantities of books like those purchased by William Neil.

- C.4. *Verify that New West has developed and implemented procedures to discontinue the use of personal credit cards to procure goods and/or services on behalf of New West.*

New West implemented procedures requiring approval of all purchases, regardless of the method of purchase, prior to procurement. The audit team did not find any instances of individuals using personal credit cards to purchase goods or services on behalf of New West.

- C.5. *Verify that Governing council resolutions are implemented and operational, specifically, the requirements passed in regard to established check issuance safeguards. Determine the propriety of all checks issued to "cash" or "bearer," and ensure that the policies include the prohibition of checks issued to "cash" or "bearer." Furthermore, ensure that checks are not made "payable to" the check signer.*

The audit team reviewed the propriety of 20 checks from FY 2003-04 totaling \$10,742.52 (identified in the A&I review), which New West staff either wrote to “cash” or paid to themselves. All the questionable checks fell into one of three categories: (1) Payments for field trip buses, (2) expense reimbursements, or (3) earned salary advances. As shown in Exhibit 6a, New West was able to provide adequate support for \$9,296.44 (87 percent) of the questionable checks, but could not provide support for \$1,446.08 (13 percent).

Exhibit 6a
New West is Only Able to Support 87 Percent
of the Questionable 2003-04 Checks

Payee	Signature	Total Number of Similar Checks	Total Amount of Checks	Amount for Which New West Provided Adequate Support	Unsupported Amounts	New West's Stated Purpose	Audit Team Notes
Cash	Meade	5	\$2,850.71	\$2,850.71	\$-	Cash paid to bus company for school field trips	
Cash	Gill	1	\$270.00	\$270.00	\$-	School bus money	
Gill	Gill	6	\$2,943.23	\$2,889.13	\$54.10	Expense reimbursements	No support or identification of the nature of the reimbursement for \$54.10.
Campbell	Campbell	5	\$566.99	\$431.23	\$135.76	Expense reimbursements	No support for \$70 in books, \$6.36 in supplies, or \$59.40 for keys.
Gill	Wire transfer (Gill)	1	\$1,465.59	\$209.37	\$1,256.22	Cobra expense reimbursements	One of seven monthly receipts (\$209.37) provided. Delta's financial officer stated that he initiated the transfer based on the single monthly receipt and Gill's indication on the receipt that he incurred the expenses for seven months. New West was unable to provide support for the other six months.
Campbell	Campbell	2	\$2,646.00	\$2,646.00	\$-	Earned salary advances	
Totals		20	\$10,742.52	\$9,296.44	\$1,446.08		

Delta's financial officer explained that the six checks written to “cash” were to pay bus companies the school used for field trips because the bus companies required either cash or a cashier's check. The audit team was able to verify that all these expenditures were valid by reviewing copies of the cashier's checks purchased by New West staff and by reviewing the bus company invoices.

The audit team was able to fully verify seven of the 12 expense reimbursements for Gill and Campbell by reviewing the cancelled checks and supporting receipts. Eleven of the reimbursement checks were for items such as educational conferences, phone charges, and school supplies. As shown in Exhibit 6a, the audit team verified all but approximately \$190 of these expenses. Regarding the reimbursement to Gill for Cobra expenses, Delta's financial officer reported that the check in question was for seven months worth of Cobra reimbursements. Although the explanation is plausible, New West could provide a receipt for only one month, leaving \$1,256.22 unverified.

Moreover, Delta's financial officer explained that the earned salary advances (ESA) are mid-month advances to all New West employees so that employees can be paid twice a month. The ESA amount is equal to one-half of their monthly total net pay after deductions, and New West deducts this amount from each monthly paycheck. According to the financial officer, in writing these checks to all employees during a payroll conversion period, Campbell inappropriately wrote the two ESA checks in question to herself. The audit team was able to verify that New West deducted the amounts from these ESA checks from Campbell's monthly check.

Because of the lack of evidence for some items, the audit team could not completely rule out that any improprieties occurred. However, given that New West could not fully substantiate five of the 20 questionable items, it is clear that New West's internal controls at the time were inadequate.

As discussed in *Chapter 2*, subsequent to the A&I audit, New West implemented a Fiscal Procedures Manual that establishes procedures and safeguards for issuing checks. Although the manual does not specifically prohibit writing checks to "cash" or "bearer," the audit team did not find any such checks during its review of the school's general ledgers for FY 2004-05 and FY 2005-06.

C.6. Follow-up on missing receipts for the 16 invoices New West failed to provide during A&I's prior review.

The A&I auditors requested a sample of 76 FY 2003-04 expenditures from New West to test the adequacy of the school's internal controls and the reasonableness and propriety of expenditures. At the time of the audit, however, New West was only able to supply documentation to support 60 of the expenditures selected. Subsequent to the close of the A&I audit, New West produced further documentation on some of these expenditures.

The 16 "missing" expenditure items totaled \$32,841.89. Of this amount, \$10,000 represented lease payments for the school's use of the BackStreet

Gallery space. These payments are supported by the lease itself and do not require the submission of invoices.

New West provided the audit team with full support for ten of the missing 16 items (including the BackStreet payments), and partial support for two expenditure transactions as discussed below. The audit team could not find documentation for the following items:

- \$933.80 paid to the City of Los Angeles for fines against the property owner during the process of obtaining building permits for the school’s renovation work. This payment was in the form of a reimbursement to Jennifer Wen, the community representative on the governance council and school’s pro bono architect. The total reimbursement paid to the architect was \$1,261.23; however, New West was able to provide receipts only for the \$327.43 permit fee and not the fines.
- \$1,368 reimbursed to Amy Lemoine, a parent volunteer, for enrollment and admissions materials.
- \$6,992.93 reimbursed to one of the school’s founders, David Eagle. New West reimbursed these expenditures based on credit card statements, for which several receipts could not be located. New West was able to provide receipts for two items listed in the credit card statements. Details of the unsupported items in the credit card statements are shown in Exhibit 6b.

Exhibit 6b
Items New West Paid from David Eagle’s Credit Card
Statements for Which Receipts could not be Found

8/20/03	Bode Research Group (school bell system)	\$1,713.35
8/21/03	New York Pizza and Pasta	23.30
8/22/03	Staples	82.53
8/29/03	Staples	25.96
9/2/03	Office Depot	66.68
9/2/03	Super Fast Copying	44.60
10/18/03	B&B Hardware	38.18
10/20/03	Staples	714.21
10/22/03	B&B Hardware	22.59
10/22/03	Office Depot	32.64
10/22/03	Smart & Final	9.93
11/6/03	PBI Postage Meter	30.00
10/27/03	No receipts available – General Ledger entry is for “Other Supplies/Office”	3,034.25
1/24/04	No receipts available – General Ledger entry is for “Other Supplies/Office”	1,154.70
Total		\$6,992.92

In conclusion, the audit team was able to verify the validity of \$23,547.16 of these expenditures, but could not evaluate the remaining \$9,294.73 (28 percent of the amount identified as having missing receipts by A&I), for reasonableness or propriety because New West could not provide supporting documentation. It is clear that New West neither had nor followed good accounting controls at the time of these transactions.

- C.7. *Review personal credit card purchases identified in A&I's expenditure review. Trace all transactions identified on credit card statements to the supporting receipts. If New West cannot provide receipts, attempt to verify through third parties.*

Refer to item C.6. discussed previously. The audit team reviewed the personal credit card purchases identified in the A&I audit and were able to verify some, but not all of the transactions listed on the credit card statements. The audit team verified the propriety of the purchases by reviewing invoices or receipts and by verifying the existence of the assets. Some purchases were of consumable assets, and the audit team could not verify their existence. In some cases, the detail was inadequate to identify the item purchased and in two cases, the audit team could not identify the vendor. It is clear that New West neither had nor followed good accounting controls at the time of these transactions. Without valid receipts or other evidence that the school received these items, the propriety of these items cannot be verified.

- C.8. *Review debit card transactions and follow-up on questionable-looking charges, including the two debit card transactions at Disneyland identified during the A&I review. Furthermore, the safeguarding of New West debit and credit cards should be reviewed for adequacy.*

The audit team reviewed the general ledgers for FY 2004-05 and FY 2005-06 for all debit card purchases and found no significant irregularities, other than those listed in Exhibit 2b. In addition, the audit team vouched all debit card transactions for the months of May 2005 through July 2005 from the general ledger to the bank statements and found that New West had accounted for all debit card transactions. Regarding the Disney Christmas Store purchase made on October 12, 2004, New West reported that an employee used the card by accident, thinking that she was using her personal credit card. Upon realizing her mistake, she notified the school and Delta, and upon returning from vacation on October 14, 2004, reimbursed the school for the purchases made on the card. The audit team verified the reimbursement.

Finally, the audit team verified, as discussed in *Chapter 2*, that the school now has only one debit card issued in the name of both the school and the principal, and that it keeps the card locked in a file cabinet when not in use.

- C.9. *Ensure that procedures have been developed to properly distinguish invoices as paid upon the issuance of checks. Furthermore, ensure that mitigating procedures are established and operating for payments from invoice copies.*

A review of invoices selected in a sample revealed that for FY 2004-05, only 50 percent of the invoices that should have been stamped or somehow noted as “paid” were actually marked so. New West’s performance of this practice improved in FY 2005-06 with all invoices tested that should have been distinguished as “paid” being distinguished as such. Even though the audit team did not find any duplicate payments related to the 2004-05 invoices, New West should continue its efforts to consistently implement the practice of stamping or somehow noting invoices as “paid,” to minimize the risk of making duplicate payments.

D. Construction Projects

Review construction contracts for FY 2002-03 and FY 2003-04 for propriety and for evidence of competitive bids. Verify that New West has developed and implemented policies and procedures regarding its subsequent construction contracts. Also, investigate the relationships between New West and architect Jennifer Wen and Golden Star Construction.

As noted in the A&I audit, New West did not receive competitive bids for the construction projects performed in 2003 and 2004. However, due to the recommendation contained in the A&I audit the school pursued obtaining bids for the 2005 construction work.

The audit team reviewed documentation, provided by New West, showing its attempts to obtain competitive bids for the 2005 renovations for its library and media center. The documentation shows that the school contacted five companies for construction bids. Only two of the five submitted bids. Two of the firms contacted never returned New West’s calls; and one firm made an appointment to view the job site and pick up architectural plans, but failed to keep the appointment. The two firms that provided bids for the renovation work were Golden Star Construction and KRB Construction, with bids of \$92,320 and \$97,670, respectively. New West selected Golden Star Construction, the firm that had performed the prior two renovation projects.

To determine if a relationship existed between New West, Golden Star Construction, and Jennifer Wen, the audit team conducted searches and reviews of: company ownership information with the Secretary of State, the Internet, invoices, and bank statements. The audit team also interviewed New West staff and the owner of Golden Star Construction. The audit team found no evidence of improprieties or a relationship between any of the parties and no evidence that Ms. Wen received any benefits from her pro bono work as the school’s architect.

E. Related-Party Transactions

Determine whether any related-party transactions exist. Ensure that charter school funds were not used for the personal benefit of any governing council member, director, or fiduciary of New West. Specifically, the relationship between Jennifer Wen and New West should be further investigated to ensure that her work as the remodel architect did not result in preferential treatment or status as a “founder.” If she is identified as a founder, her status as such should be further investigated to ensure that she met the criteria as established in New West’s approved charter.

The audit team’s detailed testing did not uncover any evidence of personal benefit to governing council members or the principal of New West. However, as discussed in the A&I audit, it is improper for governing council members to write checks to themselves or to pay their own credit cards, especially without complete supporting documentation.

Further, the audit team did not find evidence that Ms. Wen gained personal benefit from acting as the school’s pro bono architect. Ms. Wen is not designated as a school founder.

RECOMMENDATIONS

In addition to the recommendations contained in chapters 1 through 5, which address the current state of New West and are not restated here, the audit team provides the following recommendations to address the deficiencies identified in the A&I audit and in the follow-up of the unfinished A&I work contained in this chapter.

New West should implement and adhere to all the recommendations in the A&I audit memorandum.

To improve its administration and controls over loan transactions, New West should:

- Ensure it is seeking loan repayment extensions, when necessary, prior to the due date of the payment.
- Before entering into the transaction, create a proper paper trail for all loans including a loan agreement, evidence of governing council approval, and documentation showing approved loan repayment methods.

To strengthen its administration and controls over expenditures, New West should update its Fiscal Procedures Manual and implement policies:

- Prohibiting payments for items shipped to an address other than New West, billed to an entity or individual other than New West, or to personal credit cards without approval and proper receipts.

- Prohibiting the writing of checks to “cash” or “bearer” or to the person signing the check.
 - Requiring staff to stamp or somehow mark all paid invoices as “paid.”
 - To eliminate the appearance of improprieties, New West should continue to seek evidence/justification or seek reimbursement for the unsupported expenditures identified in this chapter, particularly the October 27, 2003 and January 24, 2004 items listed in Exhibit 6b.
-

(Endnotes)

- ¹. Please see Appendix A for a complete summary of the California Department of Education’s A&I Division’s March 2005 findings and recommendations.
- ². One vice principal is also a teacher.
- ³. Feddersen and Company, LLP, Certified Public Accountants, conducted New West’s fiscal year (FY) 2003-04 external financial audit. This is an annual, recurring audit designed to express an opinion on New West’s financial statements.
- ⁴. The principal or her designee made these transactions.
- ⁵. New West fits into this category.
- ⁶. The person who stole the computer was caught on the school’s surveillance system and reported to the police. According to school staff, although the police arrested the perpetrator, they did not recover the computer.
- ⁷. Although Delta’s financial officer is a financial advisor for EPCS, he does not sit on the EPCS or New West Board of Directors/Governing Council or have authority to make loans.
- ⁸. P-2 represents the Second Principal Apportionment in which funding is distributed to schools pursuant to a statutory student attendance based formula.

APPENDIX A

Summary of March 2005 Audit Findings and Recommendations From the California Department of Education Audits and Investigations Division

Weak Internal Controls	Addressed in This Report, Chapter:
<p>Observation 1 New West does not have adequate internal controls over purchasing and does not adequately segregate duties for significant accounting processes.</p> <p>Findings</p> <ul style="list-style-type: none"> • New West's office manager received cash, prepared cash deposits, and made deposits. • New West's office manager purchased goods and services, received goods and services, generated checks, and signed checks. • New West's council chair had check-signing authority and was authorized to make purchases on behalf of the school with no secondary signature required on checks. • New West allowed its council chair to make unrestricted credit card purchases that were subsequently reimbursed to him. • New West allowed its council chair to commingle personal purchases with school purchases on personal credit cards. • New West council and staff were not following its guidelines that called for all checks amounting to \$2,500 or more to contain dual signatures. <p>Recommendation 1 Implement policies and procedures to ensure separation of duties and safeguarding of assets.</p>	2
<p>Observation 2 New West did not maintain adequate controls over its fixed assets.</p> <p>Findings</p> <ul style="list-style-type: none"> • New West did not maintain adequate fixed asset information to ensure that it properly accounts for its assets. • New West did not affix identification labels to its fixed assets. • New West did not conduct regular inspections of fixed assets. <p>Recommendation 2 Maintain complete inventory records containing asset descriptions, acquisition dates, useful life, location, serial numbers, cost, and accumulated depreciation; conduct annual physical inventories of assets.</p>	2
<p>Observation 3 Debit cards were not adequately safeguarded or secured to prevent unauthorized or personal purchases.</p> <p>Findings</p> <ul style="list-style-type: none"> • New West issued debit cards in the name of the individual holding them, not in the name of the school. • New West allowed debit cards to be carried by individuals rather than safeguarding the cards at the school while not in use. • Poor internal controls led to the debit cards being inadvertently used for personal purchases by New West employees. <p>Recommendation 3 Implement safeguards over the custody and use of debit cards; issue debit cards in the name of the school to avoid use for personal purchases.</p>	2

Weak Internal Controls (<i>continued</i>)	Addressed in This Report, Chapter:
<p>Observation 4 New West did not maintain adequate documentation for expenditures or provide an adequate audit trail to ensure costs are related and necessary to the school. At times, these weaknesses resulted in duplicate payments.</p> <p>Findings</p> <ul style="list-style-type: none"> • New West often paid expenditures based on credit card statements without original purchase receipts. • New West used credit cards that were not in the name of the school to make major purchases for the school. • New West routinely paid invoices billed to other entities. • New West did not require original invoices for payment or reimbursement. • New West did not employ consistent methods to distinguish invoices as paid. <p>Recommendation 4 Implement a process to document purchase requests, approvals, and payment of school expenditures; maintain original invoices to provide an audit trail for support of all school expenditures.</p>	2
<p>Observation 5 New West had little or no controls over contracting.</p> <p>Finding</p> <ul style="list-style-type: none"> • New West did not obtain multiple bids and/or establish a clear scope of work for several significant construction contracts awarded to renovate the school building. <p>Recommendation 5 Develop procedures to ensure that all contracts and agreements clearly identify the scope of work and institute a governing council approval process to ensure all contracts, loans, and agreements are in the best interest of the school and reflect reasonable market value.</p>	4
<p>Observation 6 The election process did not ensure the integrity of ballot tallying.</p> <p>Finding</p> <ul style="list-style-type: none"> • A council candidate was responsible for tallying votes of the council election for which he won. <p>Recommendation 6 Develop and implement written policies and procedures delineating the governing council selection process to ensure that individuals running for election are not part of the vote tallying process.</p>	5
<p>Observation 7 Internal controls over bank accounts were not adequate to detect recording errors or irregularities in a timely manner.</p> <p>Findings</p> <ul style="list-style-type: none"> • Fifteen checks from one account were payable to individuals that were also the sole signer on the checks. • Checks from the fundraising activity account were payable to “cash.” • Debit card use did not require advance authorization. <p>Recommendation 7 Reconcile bank statements to accounting records on a monthly basis to timely detect errors or irregularities.</p>	2

Expenditures	Addressed in This Report, Chapter:
<p>Observation 8</p> <p>New West was not maintaining adequate support for expenditures to provide substantiation for the reasonableness and propriety of expenditures.</p> <p>Findings</p> <ul style="list-style-type: none"> • Out of a sample of 76 expenditures selected for testing, the school could provide support for only 60. • Not all of the supporting documents provided for the 60 expenditures provided adequate substantiation for the purchase. • New West paid several invoices billed to other businesses rather than to New West. • Some invoices indicated shipping addresses other than the school's address. • Several invoices contained such limited information that it was impossible to determine whether the school received the goods or services. <p>Recommendation 8</p> <p>Implement control procedures to ensure all expenditures are adequately documented with purchase requests, approvals, and original invoices; ensure that all expenditures are reasonable and necessary to the operation of the school.</p>	2
Related-Party Transactions	
<p>Observation 9</p> <p>New West entered into several related-party contracting agreements and arrangements that the auditors considered improper business transactions because they increased the opportunity for misappropriation or personal gain to the related parties.</p> <p>Findings</p> <ul style="list-style-type: none"> • One of the founding governing council members loaned New West \$300,000 in 2002 via a personal line of credit. New West's council retroactively approved the loan note in 2004. • The school engaged in questionable practices on the \$300,000 loan by making direct payments of credit card and mortgage bills for the founder. • New West secured a \$100,000 short-term, interest free loan in 2003 from a parent. A company called Nowa Derm issued the loan proceeds check to New West; however, the school's repayment of the loan was made payable directly to the parent and not to Nowa Derm. • In 2004, New West obtained a \$2,000 interest free loan from Delta Managed Solutions; the school's contracted financial manager. <p>Recommendation 9</p> <p>Implement written conflict-of-interest policies, which include full disclosure, abstention from discussion, and abstention from decision-making requirements if a related-party transaction exists.</p>	5
Other	
<p>Findings</p> <p>The A&I audit identified other concerns that were outside the scope of its audit objectives. The other findings led the auditors to express concern over New West's cash flow and its ability to continue to effectively operate as a viable charter school.</p> <ul style="list-style-type: none"> • During 2004, New West secured an interim cash flow loan for \$50,000 from Eagle's Peak Charter School. • New West actively and aggressively solicited contributions from student families. 	3

APPENDIX B

Items Requested by the California State Board of Education in its May 2005 Notice to Cure Letter to New West Charter School

	Documentation Requested
1.	Evidence of the maintenance of complete inventory records containing asset descriptions, acquisition dates, useful life, location, serial numbers, cost, and accumulated depreciation.
2.	Evidence that the school conducts annual physical inventories of assets and reconciles the inventories to the accounting records.
3.	Policy requiring the capitalization of property for accounting purposes when the property has a normal life of at least one year and a per-unit cost of at least \$1,000, and evidence that accounting staff have been trained on the methods and procedures for the capitalization of the property in the general ledger and record retention procedures.
4.	Evidence that bank accounts, credit cards, and debit cards are assigned in the name and address of New West to avoid the use of personal credit cards, and that the school maintains secure school credit and debit cards to prevent unauthorized or personal purchases.
5.	Evidence the school has implemented a process to document purchase requests, approvals, and payment of school expenditures, and that it maintains original invoices to provide an audit trail and support for all school expenditures.
6.	Procedures to ensure that all contracts and agreements clearly identify the scope of work to be performed.
7.	Evidence of a governing council approval process to ensure that all of New West's contracts loans, and agreements are in the best interest of the school and reflect reasonable market values.
8.	Policy requiring the approval from the governing council and proper documentation and execution of the notes for all borrowings over \$5,000, and evidence that accounting staff has been trained on methods and procedures for recording borrowings in the general ledger and records retention procedures.
9.	Written policies and procedures delineating the governing council selection process to ensure that individuals running for election are not part of the vote tallying process, and evidence that new policies have been implemented.
10.	Procedures that require: (1) annual approval by the governing council of all authorized signers and bank accounts; (2) reconciliation of bank statements in a timely manner by someone other than the persons that participate in the receipt and disbursement of cash; (3) preparation of checks to vendors and representatives of the school only from original invoices; and, (4) establishment of certain threshold dollar amount over which governing council approval and two signatures are required.
11.	Evidence of a written conflict-of-interest policy, which includes full disclosure, abstention from discussion, and abstention from decision-making requirements if a related-party transaction exists.
12.	Evidence of the installation of a system and implementation of a written policy on procedures and instructions in order to maintain and reconcile the attendance of the school. Evidence that appropriate members of school staff have been cross-trained in the policies and procedures
13.	Revised P-2 ⁸ for 2004 to report the correct ADA for the fiscal year ending June 30, 2004.

December 1, 2005

Mr. Thomas E. Henry
Executive Officer
Fiscal Crisis & Management Assistance Team
1300 – 17th Street, City Center
Bakersfield, CA 93301

Dear Mr. Henry,

New West Charter School has reviewed your draft audit report entitled “Internal Draft Report of the New West Charter Middle School Follow-Up Audit”. We appreciate the opportunity to respond to the draft report. Enclosed is the New West Charter School response to the report’s recommendations.

We truly appreciate the attention to accuracy and detail that the MGT auditors put into the process. MGT staff have been professional and at all times available to discuss the issues. Please extend our appreciation to those who participated in this review.

As indicated in the enclosed response, New West continues to improve its financial management and is committed to making further improvements by addressing the issues presented in this report. If you have any questions concerning the response, please contact me at 310-943 5444.

Sincerely,

(signed by Sharon Weir)

Sharon Weir, Ed. D.
Director/Principal

New West Overview Response to
Follow-Up Audit by MGT of America
Dated November 30, 2005

Presented to:

Mr. Thomas E. Henry, Chief Executive Officer
Fiscal Crisis & Management Assistance Team
1300 - 17th Street - City Centre
Bakersfield, California 93301-4308

December 1, 2005

Overview of New West Response to MGT Audit

New West accepts the factual findings of the MGT Follow-up Audit of November 30, 2005, and will implement all of the auditor's recommendations to continue to improve the school's financial management and administrative procedures. New West believes that the audit exceptions are typical of what should and can be expected of any new charter school or any other small start-up business. New West regrets the tone of certain pessimistic language reflective of past inadequacies of a new school going through the labors of opening. New West would prefer a more optimistic tone about the achievements of a successful school committed to continued improvement in the management of its financial affairs. The audit exceptions in the months before and after the school's opening in September 2003 are attributable to the lack of any substantive written fiscal policies at the time. In contrast, the few audit exceptions in the last six months are typical of a fledgling charter school in substantial compliance with its new Fiscal Procedures Manual and sound business practices. New West is pleased to have independent confirmation that there has been no financial impropriety, misuse of public funds, conflict of interest, fraud, embezzlement, or other fiscal irregularities. There is the embarrassment, however, that New West is less than 100% compliant with some of its fiscal policies and procedures. New West welcomes the auditor's detailed recommendations for improvement. New West will not be satisfied with its financial management until the school meets standards as high as the school's exemplary academic performance.

1

2

New West's fiscal affairs have been audited three times in the last year covering the school's start-up to the present (June 2003 to September 2005).¹ Most audit exceptions took place in the first six months when the school site was developed and the school opened in a new building with new teachers, new parents, and new students. Unfortunately, the founding Principal/Director and the outside firm responsible for the school's financial management failed to develop and implement written fiscal policies and procedures. The Governance Council, which did not begin oversight until its first meeting on October 28, 2003, eventually negotiated the resignation of the Principal/Director at the end of the 2003-04 school year. Equally damaging were the complaints of a group of dissonant parents who advanced their agenda through personal attacks on the school's founder, including unsubstantiated charges of financial improprieties. These complaints², now known to be without merit, led to the CDE's A&I audit³ and the eventual resignation of the school's founder from the Governance Council in June 2005. New West leadership during 2004-05 became problematic because of the health-related resignation of the school's second Principal/Director and stewardship for several months under an excellent but temporary interim Principal/Director.

New West is now stable administratively under the leadership of Dr. Sharon Weir, who came to New West in February 2005 from her position as director of the highly regarded Seashore Learning Center in South Padre Island, Texas. New West now has a Fiscal Procedures Manual approved by its Governance Council in April 2005. The manual was then

revised in July 2005 in response to the recommendations of the A&I audit. The school staff was trained in April and July 2005 in the fiscal procedures that must be followed. Dr. Weir has extensive knowledge of the school's fiscal policies and procedures because of her involvement with the A&I and MGT audits. She is as committed to resolving any and all audit exceptions as she is to further improving New West's academic standing.

3

New West is pleased to find that the MGT audit revealed that the school is already in full compliance with many policies in its Fiscal Procedures Manual. New West is also already 100% compliant with other policies that the auditor suggests should be added in writing to the Fiscal Procedures Manual. In the remaining instances, where audit exceptions were noted, New West intends to continue to improve its practices as recommended by the auditors. New West will take the following actions to guarantee improvement in the school's fiscal management:

4

- Implement, immediately, financial and management practices that bring the school into full compliance with all audit recommendations as of December 1, 2005.
- Formulate a formal, written Implementation Plan by January 15, 2006, that specifies how the school intends to address the concerns raised in the A&I and MGT audits. New West will work with the Charter Schools Division of the CDE in developing this plan and will submit 60 day, 6 month, and 12 month reports on the school's progress toward meeting the goals of the Implementation Plan.
- Hire an on-campus business manager to take over the fiscal and administrative management services now performed by Delta Managed Solutions in Sacramento.
- Revise the Fiscal Procedures Manual to take into account all A&I and MGT audit recommendations.
- Conduct annual and ongoing training of staff on sound fiscal practices in accordance with the Fiscal Procedures Manual (to be conducted by the on-campus business manager).
- Institute a voluntary program of monthly, on-site, "snap-shot" small sample audits conducted to assure continued compliance with the Fiscal Procedures Manual (to be conducted by Ms. Bessie Wong, CPA, who is an elected parent representative on the Governance Council).
- Continue the strategy of paying down loans for the school's start-up costs as aggressively as possible while maintaining adequate cash reserves to guarantee the school's fiscal viability.
- Apply to the SBE for a one-year extension of the school's Charter to a full five years ending June 30, 2007. This extension provides time to demonstrate to the LAUSD and the SBE, in anticipation of charter renewal beginning July 1, 2007, that New West has fulfilled the Implementation Plan and can manage its fiscal affairs without exception.

New West Individual Response to
Follow-Up Audit by MGT of America
Dated November 23, 2005

Presented to:

Mr. Thomas E. Henry, Chief Executive Officer
Fiscal Crisis & Management Assistance Team
1300 - 17th Street - City Centre
Bakersfield, California 93301-4308

December 1, 2005

EXECUTIVE SUMMARY

MGT Finding: “New West Developed New Fiscal and Administrative Procedures but Has Not Consistently Implemented Them”

1) New West Response: New West has been working to improve the implementation of the internal controls and will continue to strive to perfect the system to ensure all recommended controls are put in place CONSISTENTLY.

MGT Finding: “Many Prior Audit Questions Related to FY 2003-04 Resolved — Some Questions Remain”

2) New West Response:

While there was some inconsistency with putting into practice the fiscal procedures in the first year, it is very clear from the MGT Audit Report that New West has indeed made a significant improvement in year 2004-05 and even more so in year 2005-06. As the Audit Report stated, “Although the school did not exercise sound controls in this transaction, the audit team did not find any evidence of improprieties.”

Furthermore, MGT Audit Report states that since 87% of the checks were properly substantiated there were only 13% with no support provided. “Although the school did not exercise sound controls in this transaction, the audit team did not find any evidence of improprieties.” A reasonable conclusion should be that there were no improprieties at all.

5

3) MGT Recommendations - New West agrees to all of the following recommendations to improve its fiscal management:

“The following highlights some of the key recommendations from this report. Please refer to the end of each chapter for a complete list of recommendations.”

“To improve its administrative and accounting internal controls, New West should:

- Consistently implement and monitor its procedures requiring the use of purchase orders and requisitions for purchases, original invoices prior to making payments, and goods received reports with dual signatures.
- Promptly investigate and resolve all items not in compliance with its fiscal procedures.
- Closely control and monitor the use of its debit card.
- Implement a policy for receiving goods during school closures—to ensure delivery of all school purchases to the school.

- Revise its policy requiring dual signatures on checks greater than \$1,000 to require dual signatures on all checks.
- Maintain a log of cash and checks received and deposit all cash and checks within seven days of receipt.”

“To improve its cash position and cash management abilities, New West should:

- Strive to accumulate cash reserves of at least one full payroll and continue its efforts to secure a revolving line of credit for contingencies.
- Establish and implement policies for cash-flow management and cash budgeting, including a cash-flow contingency plan.”

“To improve its contracting practices, New West should update its contracting procedures to require:

- Contract monitoring to ensure all parties fulfill the terms of contracts.
- Staff to maintain documentation in the contract file evidencing the competitive bids obtained and the justification of need.
- Staff to make all contract modifications in writing and prohibit initiation of services or continuance of a contract until the contract is properly executed—including prior governing council authorization.”

“The audit team provides the following recommendations to address the deficiencies identified in the A&I audit and in our follow-up of the A&I audit work for FY 2003-04. To further improve its administration and accounting internal controls, New West should:

- Implement and adhere to all the recommendations in the A&I audit memorandum.
- Prohibit payments for items shipped to an address other than New West, billed to an entity or individual other than New West, or to personal credit cards without approval and proper receipts.
- Create a proper paper trail for all loans including a loan agreement, evidence of governing council approval, and documentation showing approved loan repayment methods.
- Prohibit the writing of checks to ‘cash’ or ‘bearer.’
- Require staff to stamp all paid invoices as ‘paid.’ ”

“Finally, New West should continue to seek evidence/justification or seek reimbursement for the unsupported expenditures identified in this report.”

6

It is evidenced by the result of the MGT audit that New West continues to tighten up the controls with new procedures, and the plan to put additional procedures in place. The “exceptions” were substantially reduced year by year.

CHAPTER 1: BACKGROUND

CHAPTER 2: SAFEGUARDING OF ASSETS (Year 2003-04)

A. Controls over Disbursements

MGT Finding: “New West Disbursement Functions Had Significant Control Weaknesses”

7

4) New West Response: 2003-4 was the very first year of operation for New West and the audit proves that significant improvement has been made since.

MGT Finding: “New West Has Developed Policies for Procurement and Disbursement but is Not Consistently Following Them”

5) New West Response: The audit noted substantial improvement in following the purchasing and payment procedures in the school’s Fiscal Procedures Manual, i.e.: the Fiscal Procedures Manual had been revised and updated to ensure prior authorization for purchases; proper approval for reimbursements; control is also now in place when goods are received by staff of New West; the control of the usage of debit card; the elimination of the potential for duplicate payments, and shipping of goods to an address other than New West. These have not occurred since 2004. As a result of the commitment the exceptions have decreased significantly (from 87% to 13% of the sample tested by MGT) within a short period of 3 months. New West understands that these must be followed consistently

MGT Finding: “New West Does Not Consistently Follow Its Procedure Requiring Dual Signatures on Checks for More Than \$1,000”

8

6) New West Response: The dual signatures policy was introduced to New West in April 2005. In the short period of 4 months New West had shown significant improvement ranging from 71% compliance to 100% as evidenced by the MGT audit result. This will be increased to 100% compliance consistently.

B. Controls Over Cash

MGT Finding: “New West Updated Its Fiscal Procedures Manual and Conducted Training for Staff”

7) New West Response: As indicated in the MGT Audit Report New West did not receive any written guidelines or training for its cash control until April 2005. The MGT audit shows that “...the office manager and staff exhibited familiarity with the policies and indicated that they understood the procedures as well as the importance of having an adequate separation of duties.” New West will continue to adhere to policy on cash controls as we understand that this is a vital procedure to follow.

MGT Finding: “New West Is More Timely in Making Deposits, but Does Not Consistently Make Deposits within Seven Days as Its Procedures Require”

8) New West Response: New West will review in its entirety the manner of depositing and recording checks. We will make every necessary adjustment to accomplish a timely system for depositing checks.

MGT Finding: “New West Maintains Adequate Controls over Bank Reconciliations and the Issuance of Its Debit Card”

9) New West Response: Noted and Agreed

C. Controls Over Fixed Assets and Textbooks

MGT Finding: “New West Implemented a Fixed Asset and Textbook Inventory Tracking System and Procedures”

10) New West Response: Noted and agreed

MGT Finding: “New West Determined that It Had Several Missing Items upon Completion of Its Inventory Count of Fixed Assets”

11) New West Response: New West agrees that this is an unfortunate occurrence and has taken proper measures to safeguard all the assets as suggested in the MGT Audit Report. We are confident that “With its new procedures and systems in place, New West has reduced the likelihood of further losses” as outlined in the MGT Audit Report.

MGT Finding: “New West’s Asset Tracking Systems are Working as Designed”

12) New West Response: Noted and Agreed

D. MGT Recommendations

New West agrees to all of the following recommendations to improve its fiscal management:

“To improve its controls over purchasing and disbursements, New West should:

- Fully implement and monitor its procedures requiring the use of purchase orders and requisitions for purchases, original invoices prior to making payments, and receiving reports with dual signatures for goods received.
- Promptly investigate and resolve all items not in compliance with New West’s fiscal procedures.
- Closely monitor and control the use of its debit card and promptly investigate any deviations from its procedures.
- Implement a policy for receipt of goods during school closures to ensure delivery of all school purchases to the school.
- Revise its policy requiring dual signatures on checks greater than \$1,000 to require dual signatures on all checks.
- Notify the bank of its policy requiring dual signatures on all checks.”

“To improve its controls over cash, New West should:

- Maintain a log of cash and checks and deposit all cash and checks within seven days of receipt.
- Conduct surprise cash counts periodically to ensure staff receive and record all cash promptly and accurately.
- Ensure it completes bank reconciliations in a timely manner.”

“To improve its controls over its fixed assets, New West should:

- Consider implementing electronic fixed-asset and textbook tracking and inventory systems.
- Implement a checkout system for portable equipment to track the user and location of the asset.
- Follow its policy for conducting annual physical inventory counts.”

CHAPTER 3: NEW WEST'S FISCAL VIABILITY

MGT Finding: “New West’s Limited Cash Reserves Make it Vulnerable to Insolvency if Circumstances Change”

13) New West Response: The school indeed continues to face low cash reserves for the remainder of the fiscal year as a result of lower than expected ADA in 2004-5, but is on track to improve the balances significantly by the end of the 2005-6 year. New West understands the importance of building up reserves for unforeseen financial needs and is working hard to accumulate sufficient cash reserves.

MGT Finding: “New West Lacks Written Policies for Cash Management”

14) New West Response: New West will adopt written cash management and debt management policies and incorporate them into our fiscal procedures manual immediately.

MGT Finding: “New West’s Reserve Balance Dipped, but Shows Recovery in Coming Year”

15) New West Response: As shown in the MGT Audit Report New West has shown steady improvement in the reserve balance. New West will make this one of its priority to ensure that the school continues to be financially viable.

MGT Finding: “The Assumptions behind New West’s Cash-Flow Projections Seem Reasonable”

16) New West Response: Noted and Agreed

MGT Recommendations

New West agrees to all of the following recommendations to ensure continued financial viability:

“To improve its cash position and cash management abilities, New West should:

- Strive to accumulate cash reserves of at least one full payroll and continue its efforts to secure a revolving line of credit for contingencies.
- Establish and adhere to written policies for cash-flow management and cash budgeting, including a cash-flow contingency plan.”

CHAPTER 4: CONTRACTING PROCESSES

Controls Over Contracting

MGT Finding: “New West Developed But Does Not Fully Comply With Its Contracting Procedures”

17) New West Response: New West will make sure all future contracts are reviewed by the Governing Board and a qualified attorney before execution. New West will also monitor all future contracts to ensure all parties fulfill the terms of contracts.

MGT Recommendations

New West agrees to all of the following recommendations to improve its contracting processes:

“To improve its contracting practices, New West should update its contracting procedures to require:

- Contract monitoring to ensure all parties fulfill the terms of contracts.
- Staff to maintain documentation in the contract file evidencing the competitive bids obtained and the justification of need.
- Staff to make all contract modifications in writing and prohibit initiation of services or continuance of a contract until the contract is properly executed—including prior governing council authorization.”

CHAPTER 5: GOVERNANCE

MGT Finding: “New West’s Governing Council Has Adopted and Implemented Election Procedures”

19) New West Response: Noted and Agreed

MGT Finding: “New West Established and Implemented Conflict-Of-Interest Policies and Procedures”

20) New West Response: Noted and Agreed

MGT Finding: “The Audit Team Found No Evidence of Fraud or Preferential Treatment Concerning the Related-Party Transactions”

21) New West Response: Noted and Agreed

MGT Recommendations

Noted and Agreed

“To ensure sound governance of the school, New West should continue its efforts to implement and adhere to the recommendations made by the A&I auditors with respect to governance and related-party transactions.”

CHAPTER 6: FOLLOW-UP ON A&I’S AUDIT WORK

MGT Recommendations

New West agrees to all of the following recommendations to improve its fiscal management:

“In addition to the recommendations contained in Chapters 1 through 5 — which address the current state of New West and are not restated here — the audit team provides the following recommendations to address the deficiencies identified in the A&I audit and in our follow-up of the unfinished A&I work contained in this Chapter.”

“New West should implement and adhere to all the recommendations in the A&I audit memorandum.”

“To improve its administration and controls over loan transactions, New West should:

- Ensure it is seeking loan repayment extensions, when necessary, prior to the due date of the payment.
- Create a proper paper trail for all loans including a loan agreement, evidence of governing council approval, and documentation showing approved loan repayment methods—in advance of entering into the transaction.”

“To strengthen its administration and controls over expenditures, New West should update its Fiscal Procedures Manual and implement policies:

- Prohibiting payments for items shipped to an address other than New West, billed to an entity or individual other than New West, or to personal credit cards without approval and proper receipts.
- Prohibiting the writing of checks to ‘cash’ or ‘bearer’ or to the person signing the check.
- Requiring staff to stamp all paid invoices as ‘paid.’
- To eliminate the appearance of improprieties, New West should continue to seek evidence/justification or seek reimbursement for the unsupported expenditures identified in this Chapter—particularly the October 27, 2003 and January 24, 2004 items listed in Exhibit 6a.”

(Endnotes)

1. The three audits are: (1) New West’s annual independent audit of December 2004 for 2003-04 fiscal year by Fedderson and Company, LLP, Certified Public Accountants; (2) CDE’s Audits and Investigations Division audit received by New West on April 19, 2005, but dated March 2, 2005, covering the period July 2003 to June 2004 (i.e., the A&I audit); and (3) the present MGT of America, Inc., follow-up audit issued December 5, 2005, covering the period from June 2003 to October, 2005 (i.e., the MGT audit).
2. These complaints were communicated to the CDE but not shared with New West for months until the CDE was informed of the school’s intent to file a Freedom of Information request for copies of all complaints against the school.

The Audit Team's Comments on the Response from New West Charter Middle School

To provide clarity and perspective, we are commenting on the New West Charter Middle School's (New West) response to our audit. The numbers correspond to the numbers we have placed in New West's response.

- 1 The audit team believes that the tone of the audit is fair and reasonable based on the facts and findings presented. We find it disconcerting that New West finds the tone of the audit to be "pessimistic" and question whether New West fully understands the magnitude of problems that can occur—as we outline in the report—when sound internal control practices are not followed.
- 2 New West's statement is misleading and overstates the findings in the audit report. Although the audit team did not find specific evidence that improprieties occurred, some items remain unresolved. Specifically, New West is unable to provide evidence to support the validity of several expenditures or the existence of three fixed asset items—leaving open the question as to whether improprieties occurred. Therefore, it is inaccurate for New West to assert that "there has been no financial impropriety, misuse of public funds, fraud, embezzlement, or other fiscal irregularities." More accurately, as stated in the report: although the audit team found no improprieties, the unresolved items remain susceptible to impropriety.
- 3 The audit team found no evidence that New West is already 100 percent compliant with the recommended additions to its Fiscal Procedures Manual. For example, as discussed in the report, the audit team found that New West:
 - Does not promptly investigate and resolve items not in compliance with its procedures,
 - Neither has nor follows a policy for receiving goods during school closures,
 - Neither has nor follows a policy requiring dual signatures on all checks,
 - Does not maintain a log of cash and checks received,
 - Does not conduct surprise cash counts,
 - Does not have a checkout system for portable equipment, and
 - Neither has nor follows cash management practices.
- 4 It does not seem plausible that New West could bring itself into full compliance with all the audit recommendations immediately when New West asserts (in the next bulleted response) that it will not develop an implementation plan for addressing the audit concerns until January 15, 2006.

- 5 New West is wrong. Its statement is misleading and overstates the findings in the audit report. Although the audit team did not find specific evidence that improprieties occurred, some items remain unresolved. Specifically, as New West reiterates in its response, New West is unable to provide evidence to support the validity of several expenditures—leaving open the question as to whether improprieties occurred. Without sufficient, competent evidential matter to support all expenditures, New West’s definitive assertion that a reasonable conclusion is “there were no improprieties at all” is unreasonable. More accurately, as stated in the report: although the audit team found no improprieties, the unresolved items remain susceptible to impropriety.
- 6 It is inaccurate to imply that the audit results provide evidence that New West has a “plan to put additional procedures in place.” New West did not mention or provide any such plan to the audit team.
- 7 The audit reveals that although New West has improved its accounting and administrative controls, further improvements are needed.
- 8 New West’s response only addresses three of the four months reviewed after New West implemented its procedure requiring dual signatures on all checks greater than \$1,000. To be accurate, the audit team found that New West’s compliance ranged from zero to 100 percent (zero percent in May, 71 percent in June, 100 percent in July, and 83 percent in August).